

CoopZone Legal Network, Tele-learning session, 20 March 2013

Offering Statements 101 (focus on Ontario), with Brian Iler and Laird Hunter
(David Daughton, facilitator. Hazel Corcoran, note-taker)

NOTES

1. Brief self-introductions by all

David welcomed everyone to the call:

David Daughton, PEI

Peter Hough, NS

Nancy Elliott, NS

Anne O'Neil, NS

George Brown, ON

Penny Rintoul, ON

Ian Shewin, ON

Shelina Ali, ON

Shane Mulligan, ON

Seth Leon, ON

Paul Cabaj, AB

Dan Ohler, AB

Hazel Corcoran, AB

Laird Hunter, AB

Brian Iler, ON

2. Presentation of Offering Statements 101 (focus on Ontario) by Brian Iler, with support from Laird Hunter

Laird introduced the topic. On our initial call in January, there was a lot of interest in finance. Although the focus on today's call is on Ontario, we will ask participants to provide input from other provinces where possible. Over the years there have been many requests to have information on how securities regulations work in the various provinces. We will attempt to provide a chart in the future to cover all of the various jurisdictions. Hazel & I will take notes.

Brian :

Offering Statements are one way of raising money for co-ops. We will start by looking at other ways of financing co-ops. When we talk about the securities regime, for co-ops it's the distinct Offering Statement regime under the Ontario Co-operatives Act – which is unique in the country.

I. How do Co-ops find the capital they need?

Conventional sources

1. Family & friends
2. Financial institutions
3. Grants
4. Angel investors
5. Venture capital

- 6. IPO – traditionally the last step in a traditional business, but it's often far earlier in the process for co-ops.
- ❑ Co-ops look to the communities they serve
 1. Member investment generates loyalty

II. Example 1: WindShare Financing

- ❑ Early grants from Trillium Foundation
- ❑ Partnership with Toronto Hydro: TREC did the work, TH paid invoice for 50% @ fmv. Staff were paid far less than fmv, so these first two elements were substantial financial resources.
- ❑ Environment Canada – forgivable loan
- ❑ TAF – bridge financing pending proceeds of offering (Toronto Atmospheric Fund)
- ❑ Offering to members - ~\$800K – Preference shares with a variable dividend; member shares were also sold for a nominal amount to give membership rights.

Brian noted that TREC (Toronto Renewable Energy Co-op) incubates renewable energy co-ops. This is about “community power.”

WindShare was not a financial success. They sought to install 3 turbines, but only 1 could go forward due to community opposition.

III. Example 2: Solar Share Co-op

- ❑ Owns and operates 19 solar installations
- ❑ Have FITs from Green Energy Act
- ❑ Raised \$3.7 million in bridge financing
- ❑ Now selling Solar Bonds to pay out bridge: \$1.311M raised to date
- ❑ Non-profit: Bonds carry fixed return, surplus to TREC to be used for more development and to guarantee payments to bondholders

For this Offering Statement, it was a long, difficult process to get it approved. One of the challenges was that the model was new to the government: a non-profit co-op; they had not seen many of these. Renewable energy co-ops were new to them; these co-ops don't have business with their members but rather sell energy to the grid. However Solar Share has been a success, e.g., it sold 600,000 watts last Thursday.

IV. Ontario Co-op Law

- ❑ Ontario Legislature 1971 Select Committee Report on Co-operatives

The Report was very sympathetic, and responsive to the maturity of the agricultural co-op sector in Ontario – and its spinoffs – Gay Lea, The Co-operators, and UCO (now Growmark).

- ❑ 1973 Co-op Corporations Act that we work with today:
 1. “rights, powers and privileges of a natural person”
 2. security regulation introduced
- ❑ co-ops had been totally exempt from the usual strict requirements of the Securities Act

V. Exemptions

- ❑ Co-op securities may be sold without regulatory approval:
 1. To the first 35 security owners

2. for the first \$200,000 capital in the co-operative (may increase to \$2 million)
 3. up to \$1,000 per year per member, to a maximum of \$10,000 (may increase to \$10,000 and \$100,000, respectively)
- Exemptions can be combined – after \$200K is raised, can still raise \$1K per member per year

It is accepted that the capital markets designed for the private business sector do not meet the needs of co-operatives, as co-operatives do not offer the speculative return, or equity participation, that those capital markets expect, and

It is recognized that a co-operative's investors will be motivated as much, or more, in their investment decision-making, from a desire to avail themselves of the co-operative's services, and to encourage the development of co-operatives generally, as they will be from a desire for a satisfactory return on their investment.

"Securities" – includes shares and loans.

We had expected the increases would be in force by now; there appears to be insufficient political will to make that happen.

Penny: there are no exemptions under the CU legislation, except for member shares and shares issued as patronage dividends.

VI. Co-op Offering Statements

- Where
 1. exemptions not available, or
 2. where the marketing of co-op securities would be enhanced by a government-receipted disclosure document,
 an Offering Statement is prepared and "receipted" by FSCO.
- Co-ops should use the disciplined approach an offering statement requires even if they are not required to do so

Introduced in 1974, this process became much more elaborate in 1994, an approval process for the marketing of co-operatives' securities separate and distinct from the prospectus approval process mandated under the *Securities Act* for private sector capital markets.

Co-operatives do have the option to submit offering statements for review and receipt by FSCO even if they are not mandatory. Some co-operatives will opt to do so, as the offering statement does provide additional assurance to prospective investors that the offering has been carefully thought through, and has had the benefit of government review as well. The experience will be closely monitored.

The "receipt" process is not the same as an approval although sometimes it seems that it's treated as such. FSCO was initially pushing to have Bay Street lawyers, and were not very respectful of the Renewable Energy co-ops and their lawyers. In the last 9 months, this has changed and they now understand RE co-ops.

It is somewhat odd that FSCO is the regulator, as co-ops are not financial institutions.

VII. Goals for OSs

- Standard: “Full, true and plain disclosure of all material facts” – same as for prospectus
- Securities regulation has two goals:
 - (a) to provide protection to investors from unfair, improper or fraudulent practices; and
 - (b) to foster fair and efficient capital markets and confidence in capital markets.
- Co-op securities regulation has only one: to protect investors

FSCO makes it clear that their legislation is focused only on investor protection. We need the OSC’s balanced approach.

VIII. Drafting Offering Statements

- Key – good business plan; one cannot prepare an OS without a business plan.
- Use of “templates”: FSCO says,
“Every Offering Statement is unique and the information contained therein is dependent on the individuality of the business enterprise.”
- Provide client with sample previously approved OS to do a first draft
- Legal review requires good knowledge of co-op’s business, attention to Risk Factors

Prior to 1994, the OS process was extremely simple. Under the NDP government, we worked together to create the new process for OS’s. On occasion we have had templates endorsed by FSCO for various types of co-ops. More recently they’ve said they do not endorse templates. But, many co-ops have similar businesses so it is possible to adapt a previously received OS. The clients can then do the first draft of the OS. If they follow along carefully, the work required by the lawyers will be minimized. The lawyer needs to ensure that all material facts are disclosed.

Projections given always need to be qualified, indicating that they are not guaranteed. FSCO is very picky about editing issues, that defined terms are adequately capitalized, etc. Good editing is essential.

It is necessary to include current financial statements, audited if an audit is required.

IX. Risk Factors

- Clearly and carefully set them out
 - Prospective investors will appreciate candour
 - Can actually enhance offering’s success
 - Not every possible risk – just the “material” ones
 - Regulator tends towards excessive disclosure
- Accommodate that?
Or push back?
People have different approaches on this.

Investors will appreciate having the risk factors clearly set out. The test is whether the risk is material. There is a set of standard risk factors and warnings, which are required by the Act.

X. Issues

- Review times can be excessive
- FSCO not confident about level of skill in co-operatives to meet standard of full, true and plain disclosure of all material facts
- Led to extreme delays – for non-profit co-operatives particularly

The Solar Share application was a pioneering exercise; those coming afterward will have an easier time. FSCO has recognized that their reviewing staff were not as knowledgeable as they should have been. There are some new staff, and there is a better relationship now with them. This has made the process a much more collaborative experience, over the past year.

XI. Issues (cont'd)

- Exemptions and OS only available
 1. to Ontario-incorporated co-ops
 2. for securities sold in Ontario
- Approval times and reviewers' limited expertise hampers OS use (lately, improved)
- Confusion with energy co-ops – no business with members: “Why aren't you at the OSC?”

Co-ops that want to sell securities in other provinces have to use the rules in the other jurisdictions.

There was confusion at FSCO because they didn't understand why a non-profit co-op would wish to sell securities.

OS's in Ontario have a one-year life, from the day of the submission at FSCO; have them slip-sheet a new page to change the date closer to time of receipt

Q: Length of time to get a receipt? Brian: generally it's 4-6 weeks for the first response. After that, it depends on the extent of the changes necessary. They are expecting a large number of RE Co-op OS's in the next while, which could slow this down.

XII. 2011 Advice from FSCO

“Recent renewable energy offering statement submissions received by FSCO have been complex and novel in structure. Similar submissions will be reviewed in the order in which they are received and review times may be impacted. Please take this into consideration in your business planning if you propose to submit an offering statement in the future. We remind you that you cannot raise capital without a receipted offering statement.”

This last statement is not accurate; it ignores the exemptions. Initially they were discouraging the RE Co-ops from using the OS approach.

XIII. Do OS's work?

- Too lengthy, too verbose OS will not be read
- Other jurisdictions have pithier, more reader-friendly OSs – Australia, UK

- ❑ Co-op investors are more likely to care about the co-op's social goals, less about the investment risk (at least where the amount is small)
- ❑ The more serious the amount of money you're raising, the more the investment risk is a factor

3. Experiences in other jurisdictions:

Peter: my experience in NS and NB, the co-ops have used the [National Instrument Exemptions](#) from prospectus requirements. The CEDIF's in NS have created a simplified offering document which all have to use; some are co-ops. Brian: the NS documents are far more user-friendly than the Ontario one.

Laird: the different approaches are:

- Ontario approach (has carved out co-ops distinctly from the closed security system),
- BC approach (since 2009 has a regulation under the Securities Act for co-ops),
- Quebec approach (specific exemptions for co-ops) or
- The approach in AB, NS, NB: the requirement is to fit oneself into the exemptions under the National Instrument (45-106: Prospectus Exemptions). This allows for two kinds of offering memoranda, with possibility of harmonized exemptions in harmonized jurisdictions: so this is an advantage, if one can fit into it. This may be helpful for crossing provincial boundaries, but it's complicated by the interface between co-op and securities legislation which varies across the country.

Brian: MEC, is a BC co-op which operates in many other provinces. The only security they issue is their \$10 membership share. They spent a huge amount of money getting an exemption in Ontario to be able to sell these membership shares.

Alberta: Paul spoke about the Opportunity Development Co-ops being developed in AB. They are similar to the CEDIFs in NS, except without the tax credit. They have gotten a legal opinion on RRSP eligibility, that it's beyond agricultural co-ops. (He will share this opinion if he gets the approval.)

The largest concern of the AB Securities Commission is consumer protection. The first Opportunity Development Co-op was developed along with lawyer Brian Kahliel: Crowsnest ODC. They've done their first share issues based on the exemptions of up to 50 members, plus friends, family and connections. Co-ops can have more amenable exemptions for: up to 99 members, up to \$10,000, but unclear if this applies to loans as opposed to shares. Their next project will be a housing development in Fahler; will require drafting offering documents. In AB, there is a specific Real Estate offering document. They are spending a lot of time on these first projects.

In AB, they have had a variety of experiences with the staff at the Securities Commission. They are stating that only board members can sell shares, and they can only sell shares within the local community. A significant attraction is the RRSP eligibility, which they are accessing through the CWCF. ACCA may look at becoming a registered dealer, or create a subsidiary.

Brian: we have run into refusal by all major banks to accept shares or bonds in co-ops for RRSP eligibility.

Paul: we are only working with CWCF for now. We are questioning who we release the templates to, because of concern about fraud.

Brian: we've seen private developers seeking to set up fake energy co-ops, so the Ontario Power Authority put on a restriction around needing 50 people to be local.

Paul: we are looking at the possibility of making TSFA's eligible, too, as this would be difficult for CWCF to do. We have discussed this with CU's in AB, putting this out as an opportunity for them to be engaged as trustees.

Peter: the fact that the banks generally do not want to be engaged with the RRSP in co-ops is precisely why CWCF has offered the program.

Laird: there is some speculation around RRSP eligibility, possibly becoming more restrictive – there were clarifications made in the fall, and there may be some changes made in the federal budget tomorrow. We should watch that carefully.

David: the CED Business program is starting up, and there will have to be offering statements – investments have to be for a business certified to do CED, so the business has to include a CED plan. The rules will be completely separate from the National Instrument rules; very similar to the NS program. There are a lot of restrictions on what a business can or cannot do, e.g. at least 70% of the wages must be paid in the province.

Paul suggested that we should consider sharing documents.

Laird: those provinces which are using the National Instrument harmonized approach would have documents that could be shared. We should look at sharing these documents with each other through CoopZone, e.g. on a password-protected site.

Hazel offered to share documents among those in the group who would like to receive them, if people request this.

Brian: I am willing to share a sample document for SolarShare; it can be placed on the web site, as OS's are public documents. (NOTE: The SolarShare OS is now on the site, here: <http://coopzone.coop/en/node/3951>.)

Paul: are there any people who are registered dealers for co-ops? Brian: this is an issue on the non-profit side for community loan funds. The dealer registration exemption is for benevolent non-profits, but the dealer registration if you are not carrying on the business of dealing in securities; there is an argument that they are caught by this.

David thanked everyone for participating, with special thanks to the presenters. We'll take these suggestions to the CZ Legal Network Steering Committee & CZ Board and do further follow-up.