IN THE MATTER OF
THE SECURITIES ACT, 1988, S.S. 1988, c. S-42.2

AND

IN THE MATTER OF

FRONTIER PETERBILT SALES LTD.
AND
F P EMPLOYEES INVESTMENTS INC.
AND
GENERAL RULING/ORDER 26 - "LABOUR-SPONSORED
VENTURE CAPITAL CORPORATIONS EXEMPTIONS RULING, 1992"

D E C I S I O N

Hearing Held December 9, 1992

Before: Marcel de la Gorgendiere, Q.C., Chairman
Rand Flynn, Commission Member

Appearances: James Hall, representing Commission staff

Keith Thomson, representing the Respondent

Decision dated December 23, 1992.

DECISION

This decision comes as a result of an application to the Commission to determine whether an offering memorandum submitted to the Director of the Commission (the "Director") pursuant to General Ruling/Order 26 - "Labour-Sponsored Venture Capital Corporations Exemptions Ruling, 1992" (GRO 26) with respect to F P Employees Investments Inc., (F P Inc.) should contain financial statements for Frontier Peterbilt Sales Ltd. (Frontier) or whether the Commission should impose other terms and conditions. The Commission determined, December 15, 1992 that it would not allow the application to proceed without the financial statements as required in accordance with GRO 26 and stated it would provide written reasons in due course.

What follows now is a description of the nature of the application and an explanation of why the Commission reached the conclusion it did. They are being set out in some detail because it is not often that an exemption application results in a hearing, given the statutory nature of the unfettered discretion which can be exercised by the Commission. However, there is a considerable interest in the labour-sponsored venture capital program and a number of applications are in various stages of development. It is an important program in the minds of the Commission and the Commission developed GRO 26 with a view to facilitating applications. It feels that there would be some value in potential applicants being aware of the thinking of the Commission in regard to the one aspect of required disclosure that is dealt with in this application.

It is also of value, we believe, for the public to be aware that the Commission encourages applications to it when an applicant feels that there are important reasons to question the decisions of staff in regard to its application. It is through such applications that the Commission itself becomes more aware of the nature of the concerns of those who wish to take advantage of the program.

Details of the Application

Frontier is a private Saskatchewan corporation and is not a reporting issuer within the meaning of The Securities Act, 1988 S.S. 1988, c.S-42.2 (the Act). Frontier had indicated to the Commission staff that it wished to establish a Type B corporation pursuant to the provisions of the Labour-Sponsored Venture Capital Corporations Act S.S 1986 C.L-0-2 (the LSVCC act) that would be known as F P Inc. so that its employees could invest in Frontier and take advantage of the provisions of federal and provincial income tax act deductions that are available to employees investing in such a corporation. The LSVCC provisions require a special corporation owned by employees to receive the investment of employees which in turn are used to invest either in the common or preferred stock or debt of the operating corporation which employs them. The Offering Memorandum proposed by the applicant indicated that 60% of the proceeds of the offering of F P Inc. was allotted to the purchase of Class F Preferred Non-Voting shares of Frontier and a loan of 40% to Frontier. The Class F shares would be entitled to a fixed preferred

accumulative annual dividend of 3% and would be entitled to further dividends depending upon the profitability of Frontier determined in accordance with a ratio as set out in the description of the rights, privileges and restrictions for shares of Frontier. They take three pages to describe and the details are not particularly significant to this decision.

On June 30, 1992 the Commission issued a ruling permitting Frontier to hold informational meetings with its employees and to distribute an information package to its employees to see if there were any interests in investing in the proposed F P Inc. A series of meetings were held at the three company locations and of the approximately 70 eligible employees, 29 indicated they would be interested in investing approximately $40,000 in F P Inc. However, there was evidence that a considerable number of other employees might be interested if plans developed further. The scope of the duties of the eligible employees ranged from department managers and sales managers to apprentice mechanics and clerical staff and they had worked from one to eleven years with the company.

The solicitor for the applicant filed a draft offering memorandum in accordance with Part 2 of GRO 26 which filing initiated discussions between the Deputy Director, Exemptions and the Solicitor. The Solicitor indicated that Frontier did not want to disclose to the eligible employees the unaudited financial statements for Frontier as at its April 30, 1992 year-end. They only wished to disclose the statements to the Commission and the Department of Economic Development and to the lawyer and auditor for the eligible employees. As outlined in the Notice of Hearing and agreed to by the parties, **"the latter disclosure to the lawyer and auditor would be on the condition that the specific content of the Financial Statements not be disclosed to the Eligible Employees other than to:**

a. Confirm that the dividends paid annually to F P Inc. have been correctly calculated;

b. Indicate to F P Inc. whether or not the equity base of Frontier has declined; and

c. Indicate whether or not there is any apparent cause for concern about the security of the investment of F P Inc.

18. At the informational meetings referred to in paragraph 11 above, the employees were not given any specific financial information about Frontier other than that:

a. Frontier had an equity base of approximately $1,000,000; and

b. 1991 was a very good year with an income in excess of $375,000.....

19. The Deputy Director, Exemptions, advised the solicitors for F P Inc. that he would not approve the Offering Memorandum for use unless it included

full financial statement disclosure for Frontier."

Reasons Advanced by the Applicant

At the hearing the applicant made it clear that they were not arguing about the usefulness of financial statements to investors, but made it clear that they did not want to release the April 30, 1992 statement or any future statement other than to the restricted extent mentioned above. The Commission discussed with the applicant at the hearing the evidence relating to the use of the financial statement in the initial offering process and has reached its conclusion on that basis. It has not reached any conclusion in regard to continuous disclosure requirements. A scenario was developed that the Labour-Sponsored Venture Capital Corporation could make an application under section 150 of The Business Corporations Act to exempt the requirement of section 149 which requires financial statements to be given to shareholders, or under section 153. This could conceivably be done at the time of incorporation before it was under the control of the employees. For the purpose of this application it was not necessary to decide what the future requirements would be and if that scenario was a possibility it would be an unfortunate one but would be a provision of corporate law that would be beyond the power of the Commission to rectify but not beyond the power of the regulators for The Labour-Sponsored Venture Capital Corporation Act to make provision for rectifying before approving any corporation.

A number of reasons were advanced as to why this particular application should be granted even though it was contrary to the full disclosure principle on which the Securities Act is based. The suggestion was that there were strong reasons to make it worthwhile for the employees to consider making the investment without disclosure of the financial statements and to justify the owners in not disclosing them. These reasons were advanced as being unique and justifying the approach. The first reason advanced was that the company did not need the investment. It was operating with an adequate capital base. While it could be reasonably accepted as being a true statement of fact, the evidence of the principal shareholder and president, Kerny Korchinski, made it clear that there is more than just financial need when assessing the requirements of the company. He clearly indicated that there was value attached to the incentive of ownership based on profitability and the pride of involvement in the company. He clearly expected it would have an effect upon productivity. To that extent there was a perceived need directly related to the requirement for equity. Even if the equity was in the form of non-voting shares that paid a fixed dividend, there was the possibility of a further dividend based on a profitability formula. In the long run, such a need may be more important than any other form of debt available to the company in maintaining viability. But, even if this was not an acknowledged need, the lack of need is not relevant to the issue of what information an investor needs in making an investment. If investment is requested, what disclosure is relevant remains the question to answer.

The second point of uniqueness that was advanced was that any investment would qualify not only for transfer to an RRSP but was also subject to federal and provincial tax credits totalling 40% of the amount paid leaving a lower income employee with an after-tax cost of $260 and a higher income employee of $100 on each $1,000 invested. While this may be unique from the point of view of investors who are not able to invest in a LSVCC it certainly is, in the opinion of the Commission, not unique to any investment in an LSVCC. It cannot therefore be considered unique to the extent that financial statements are not required, because regardless of the tax saving, some capital is in fact invested and a return is expected on it.

An additional point was made that the attractiveness of the tax break would encourage employees to invest and use an RRSP which they might not normally do and therefore it was an inducement for retirement planning and should be encouraged. However, we find that while we are in perfect agreement that such an investment would be laudable as an incentive to retirement planning, it begs the question as to why it is necessary to be deprived of the benefit of perusing financial statements before effecting such an investment. This is all the more reason to consider the nature of the investment thoroughly, especially if it were to happen that more secure investments such as bonds and guaranteed investment certificates already in the investor's RRSP were to be converted into cash in order to purchase the F P Inc. shares.

The next suggestion advanced was that the company's equity base of approximately $1,000,000 and last year's income in excess of $375,000 was revealed to employees at the informational meetings without the provision of financial statements and yet the employees felt comfortable enough with that to indicate their support for investing. In fact, prior to the hearing approximately 26 employees signed a petition in which is expressed their feeling that wide distribution of the company's financial statements might lead to them getting into the hands of competition and into the hands of employees not investing in F P Inc. and that while the employees appreciated the Commission's concern that they be provided with the financial statements, and acknowledged that **"the absence of this information may very well lead us on an individual basis to not make the investment"** they still did not want the statements. They also referred to the auditor's and solicitor's of the company being provided with copies of financial statements and their opinion was stated in the petition **"although by agreement with Frontier Peterbilt Sales Ltd. pursuant to the code of professional conduct governing each of these professionals, they will be prohibited from distributing these financial statements further, our company is free to ask them their opinion with respect to anything relevant to our company's proposed and ongoing investment in Frontier Peterbilt Sales Ltd. "**

There is a possibility for at least a misunderstanding as to what was actually in the minds of those signing the petition because the solicitor indicated to the Commission in a letter of October 5, 1992 on paragraph 2, page 4, that **"The corporation is prepared to disclose its financial statements now and in the future to the lawyer and auditor that are retained by the LSVCC on the condition that**

the specific content of the Financial statements not be disclosed to the employees of Frontier Peterbilt other than to confirm that the dividends paid annually to the LSVCC have been correctly calculated and other than to indicate to the LSVCC whether or not the equity base of the corporation has declined and whether or not there is any apparent cause for concern about the security of the investment of the LSVCC." They were also prepared to disclose the current equity base and the equity base on an annual basis and as well disclose what dividends would have been paid to the LSVCC assuming that the approximately $45,000 had been invested by the LSVCC in Frontier Peterbilt three years ago. Whether that constitutes an ability of the LSVCC company to ask their opinion with respect to **"anything relevant to our company's proposed and ongoing investment",** it is in our mind in doubt.

This doubt also existed in the minds of the employee witness, Mr. Jim Sotnikow. His evidence was that employees could see the financial statements at the auditors. It was his understanding that they would not be able to remove copies of the statements. He was asked a direct question, after having heard the above excerpt of the letter from the solicitor for the applicant, whether he would still invest on that basis and he said, no. In the mind of the Commission, this situation illustrates perhaps the most effective reason why the statements should be released. Every investor has his own idea as to what is relevant or not. Verbal representations can often be misunderstood no matter how clearly they may be made. The confusion would be at an end if the information was available. As a result of the varying interpretations that can be placed on the petition, the Commission feels that even if the evidence of Mr. Sotnikow is completely ignored, the fact of the willingness to invest without the information at the time of the initial information meeting when the employees would be aware and would have been told that no contracts to subscribe would be made does not supply the Commission with a unique reason to do away with the revelation of financial statements.

The next reason advanced by the applicant as well as the applicant's employees was the need for confidentiality in a competitive business. This is an argument that the Commission does not accept. Innumerable public companies compete with private companies quite successfully with their financial statements made available annually and with quarterly unaudited statements also being made public. When questioned by the Commission as to whether it might be the peculiar form of financial statement used by the applicant that might be considered to provide segmented information that gave away competitive secrets, the president, Mr. Korchinski indicated that even the general information as to how well the company was doing could be harmful in the hands of competitors. Why does the Commission find that hard to accept? A great number of the applicant's employees are paid benefits based on some form of profit sharing. They are well aware of how well their own particular segment of the business is going. In addition, any competitor could easily find out items such as shop rates and truck prices. The Commission feels that it is quite possible to provide a reasonable degree of confidentiality in the production of financial statements and yet comply with the requirements that exist, namely, that they comply with generally accepted accounting principles as

interpreted in the Handbook of the Canadian Institute of Chartered Accountants. While it is unfortunate that the applicant felt that he would not proceed with the plan that he saw as clearly beneficial to himself and his employees if a financial statement was made available to employees prior to the offering being made, the Commission does not feel that such a reason is a legitimate defensible business purpose justifying the removal of normal disclosure requirements.

The next reason was expressed as follows by the solicitor, **"of equal concern to Frontier Peterbilt is the fact that while <u>some</u> of the employees would have a relationship with the corporation as an investor, <u>all</u> of the employees will have an even more significant relationship with the company as employees of the company. Disclosure of the financial statements to the employees would almost certainly have a disruptive impact upon the relationship between the owners of Frontier Peterbilt and the employees of Frontier Peterbilt in their labour negotiations. In their status as employees of the company, the financial statements of the company are none of their business and would almost never be disclosed to the employees. "** The Commission cannot reconcile this position with the evidence given by the President, Mr. Korchinski, in which he described the value of investment in the company by way of it being an incentive and a means of bringing out a feeling of participation and belonging to the company. One of the basic aspects of ownership is knowledge of the investment. Without the normal incidence of ownership it would be hard to see how the pride of involvement would develop. We feel that the attributes of ownership are more than merely providing money. While we are not considering the effect of not continuing to provide financial statements in future years, if that could be or might be arranged, we do feel a refusal to provide such information upon investment could have an initial disruptive effect because of the way it can be and has been misinterpreted insofar as what the future situation might be. The Commission does not feel that it would be disruptive to reveal the facts but rather more conducive to long-term labour peace and harmony.

Another reason advanced was that as the applicant company was a private company owned by private individuals they should be able to keep their finances and business affairs private. In making the concessions offered, not to raise capital, but rather to provide a benefit to their employees, their privacy should not suffer. This is somewhat a restatement of other arguments, however, the Commission in reply can only restate that there are benefits to the company from employee investment and that the knowledge of their affairs that would be made available does not have to have a significant competitive disadvantage.

Another suggestion was that the practical effect of the disclosure suggested was similar to that which would be available from investing in mutual funds or a Type A LSVCC which consisted of an investment in more than one company. Again, the Commission fails to see the validity of this argument. An investment in a mutual fund or a Type A LSVCC carries with it an investment in the management of the fund. In the case of mutual funds the information is public not only as to the record of the management of the fund, but public as to the companies in which they are investing. One places ones investment with managers who meet certain

criteria of investment management experience and they have full financial information available to them. In this particular case, while the companies advisers would have read the financial statements they would be limited in the use that they could make of the information. In a Type A LSVCC while the investments may not be in public companies, one could hardly imagine the managers investing without full financial information and their qualifications as investment managers would be known.

The solicitor for the applicant then stated, **"the final question that I would pose is 'should the Securities Commission make the decision that this level of disclosure is insufficient for the employees' purposes or should the employees make that decision?'".** The accountant for the applicant raised the same question in a somewhat different form**,** namely that the request was **"motivated by the fact that in the situation at hand there is a willing seller and willing buyers who are being prevented from carrying out their transaction by a regulatory agency which, with all due respect:**

a. has no Financial interest in the transaction,
b. accepts no responsibility for any loss incurred by either the seller or the buyer, and
c. is not prepared to pass judgement on the merits of the transaction.

From the Securities Commission's point of view, there is no question that the decision should be made by willing buyers. The question is on what basis do they become willing buyers. The fact that the Securities Commission has no financial interest in the transaction does not effect the basis on which an investor should make a decision. In fact, considering the number of contrarian investors that exist, the fact that the Commission felt that an investment was worthy of acceptance would be a reason to avoid investment. If by financial interest is meant a lack of guarantee on behalf of the Commission for those transactions in which it approves of the disclosure then one would be imposing a unique role upon a Securities Commission and budgetary constraints would soon restrict investment offers to only the secure. The aim of the Securities Commission has not been to provide some sort of product warranty but has rather been to ensure that the market operates on the basis of the knowledge of all known factors that could effect the value of the an investment and let the investor assume responsibility for a decision made on the basis of that information, and that is why it does not and will not accept any responsibility for any loss incurred by the seller or buyer. It likewise does not pass judgment on the merits of the transaction except in the case of section 70 of the Act where certain merit attributes of a prospectus are considered, such as a question of unconscionable consideration, past conduct of a promoter raising questions as to whether the best interests of the investors will be met or where it appears that the proceeds are insufficient to accomplish the purpose of the issue stated in the prospectus.

Leaving the provisions of section 70 aside, what the Act requires where there is a trade in securities, is, in accordance with section 61(l) of the Act, full, true and

plain disclosure of all material facts relating to the securities issued that are proposed to be distributed. Under section 58 a trade such as being contemplated here would require a prospectus meeting that requirement as determined by the Director. Naturally, as the applicant is aware, section 83 allows the Commission **"where it is satisfied that to do so would not be prejudicial to the public interest"** to rule that any trade is not subject to section 58, and to impose such terms and conditions in such a ruling that it considers necessary. What the Commission is attempting to do when it entertains an exemption order under section 83 is decide what level of information would not prejudice the public interest when there is a trade and a prospectus containing full, true and plain disclosure of all material facts is not provided. The Act itself sets out certain situations which provide an exemption from these requirements. We feel it is a reasonable presumption that where one cannot fit oneself within the circumstances contemplated by the legislation in its specific exemptions that the guiding principle is that full disclosure is required unless it can be shown to be unnecessary to maintain the public interest. The Commission has considered above the reasons presented for considering this "unique" application and has not accepted them as establishing a reason to deviate from full disclosure considering that financial statements are part of full disclosure.

The Commission then wishes to consider some of the arguments of the Commission staff that were put forward as a justification for financial statements when a trade is going to take place in accordance with GRO 26.

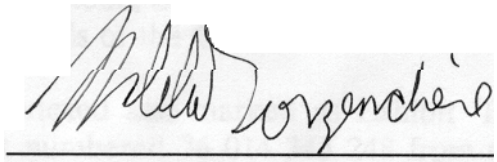
Mr. McIntosh, the Deputy Director, Corporate Finance, pointed out that whether it was in a prospectus or in an exempt offering memorandum, a financial statement had been required, not just for an indication of bottom-line income figures, but quoted the objective of financial statements as stated in the CICA Handbook. These are **"to communicate information that is useful to investors, members, contributors, creditors, and other users in making their resource allocation decisions and/or assessing managements stewardship, consequently financial statements provide information about (a) an entity's economic resources, obligations and equity/net assets, (b) changes in an entity's economic resources, obligations and equity/net assets, and (c) the economic performance of the entity. "**

Some reference was made to questions that might be raised after reading the statements that were not included in the information package given employees or in the information to be released by an appointed solicitor and auditor as outlined in the solicitor's letter that stated the restrictions on the use of financial statements.

These questions arise from the details of presentation in the different material. The financial statements would provide more information as to the definition of income and as to the existence of services provided the operating company. This in turn might, for example, lead to questions relating to the ratio for determining profitability for Type F shares. None of the questions arise from a misrepresentation but rather from a lack of information that access to a financial statement would clarify. If not, it would lead to other questions that would require an answer before a prudent investor justified the investment.

In short, the Commission does not think that a case has been presented to show that it is in the public interest that the financial statements not be provided to the employees as part of an offering memorandum prepared for them to consider when investing in this particular labour-sponsored venture capital corporation. The Commission feels that they should have the financial statements together with the information and the certification which is given as part of their preparation. The Commission further feels that this particular situation did not clearly establish what information would be released from the financial statement. Nor was it established what would be available in the future as part of the normal continuous disclosure process for subsequent statements. Confusion could result that would not be conducive to the public interest. While such matters might be capable of clarification in a revised offering memorandum, the Commission does not feel a unique reason has been advanced to justify the removal of the requirement for financial statements as part of reasonable disclosure requirements for the protection of investors.

DATED at the City of Saskatoon, in the Province of Saskatchewan, this 23rd day of December, 1992.



Marcel de la Gorgendiere, Q.C.
Chairman