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THE UNIVERSITY OF BRITISH COLUMBIA
PETER A. ALLARD SCHOOL OF LAW

FINAL EXAMINATION – DECEMBER 2019

LAW 463/576 Securities Regulation

SECTION 001

Professor Maziar Peihani

TOTAL MARKS: 100

TIME ALLOWED: 2 HOURS and 30 MINUTES

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NOTE:

1. This is an open book examination. Students may take any materials they wish into the examination room except library books.

THIS EXAMINATION CONSISTS OF TWO QUESTIONS.

Question One: 70 Marks

NorthStar Health Corp. is a Canadian corporation incorporated under the British Columbia Business Corporations Act. NorthStar maintains its corporate headquarters in Vancouver, BC and is in the business of ownership and operation of surgical centres and hospitals across a variety of specialties including orthopaedic surgery, podiatric surgery, pain management, and general surgery. NorthStar is a non-venture issuer and has one class of common shares listed on TSX under the symbol "NSC". NorthStar's Chief Operating Officer (CEO) is Jeffrey Graham and its Chief Financial Officer (CFO) is Shelly Fitzpatrick. NorthStar's financial year ends December 31.

The company pursues a rapid growth strategy through acquisitions and providing marketing and management services for its own as well as third-party facilities. The company's plan is for this marketing engine to drive growth at owned and acquired facilities. For instance, on December 1, 2017, it purchases AIT Medical Imaging and Canada Magnetic Imaging, two imaging centres operating in Surrey. Also, in December, NorthStar purchases Accrua, an experimental spine surgery clinic that offers patients exceptionally short recovery times. Although, a relatively small facility, Accrua runs a highly lucrative business and its revenues are almost a quarter of NorthStar's. On December 15, NorthStar closes its transaction, with Accrua's owners, paying 3 million in cash and 12 million by a promissory note.

The full details of the above transactions, including their financing and payment, are disclosed in NorthStar's Annual Information Form (AIF), audited annual financial statements, and the Management Discussion and Analysis (MD&A), which are filed on SEDAR on March 1, 2018. Following the release of the annual filings, Calvetti Ferguson LLP resigns from serving as NorthStar's auditor. It is succeeded by Oliver & Young LLP, effective March 8, 2018. On the same day, an anonymous internet blogger publishes the following stock analysis on SeekingAlpha.com:

> **NorthStar: A Potential House of Cards**
>
> NorthStar's key strategy is to go out on the market picking up businesses and putting them together with the promise of significant synergies and cost reductions. This strategy is commonly known as a "roll-up". Investment banks and lawyers love roll-ups as the constant stream of acquisitions provide continuing opportunities for transaction advisory and financings, both of which all add up to substantial fees. For investors, though, roll-ups are not nearly good news. Acquisitions give the impression of growth, even if the actual businesses are not growing, or even in decline. Management can continue to pay themselves handsome wages as top-line expansion continues to reinforce the market excitement about the company's underlying "growth" story. Even the traditional earnings measures of the most conservative value investors can be distorted by all the opportunities in merger accounting to shift expenses and pad post-acquisition results. Synergy realizations are rare and are more often than not unlikely to be realized. In the case of NorthStar, the company has picked up undervalued and bankrupt assets. If the underlying

> acquisitions are garbage, accumulating various acquisitions just yields a larger pile of garbage. NorthStar's prior roll-ups have resulted in large losses that are masked by a complex organizational structure and creative accounting. The company's revenue is significantly inflated and the management remains extremely well-paid and sells stock relentlessly. But with this management team and these assets, this story is likely to end very badly.

On March 15, 2018, NorthStar's board of directors issues a press release in response to the SeekingAlpha blogpost. The press release says that the blogger's "inflammatory" and "scurrilous" allegations have no merit. However, in an effort to show their commitment to full disclosure and transparency, the audit committee and the board's independent directors announce that they have appointed an outside independent counsel, Gabriela Zucman, a highly-experienced commercial litigator with Norton Stanley LLP, to conduct a full review of all allegations raised by the blogpost.

The market remains calm after NorthStar's press release and trading in NorthStar's shares continues as normal. This comes as a relief to Jeffrey Graham, who goes to play golf on Sunday, March 18th. He meets up with his old-time fraternity buddies, William Blake, the CEO of MedTech, and George Walker, an accountant with Deloitte. They both ask Jeffrey about the SeekingAlpha blogpost and whether there is any truth to it. Jeffrey refutes all the blogger's allegations and shares some of the highlights of NorthStar's annual report to show the company is on a successful track. Later at lunch, William shares the news that a new exclusive golf club is opening soon on Burnaby heights. It is run by Alex Hei, another old-time fraternity friend. Jeffrey is thrilled at the news and tells William he'd love to be a member of that club! After arriving home, George sends a secured email to his broker, instructing him to buy 10,000 shares of NorthStar. The broker executes the trade on Monday, March 19th, shortly after the markets open. Also, on Monday, Ramin Campos, a high school teacher buys 20,000 shares of NorthStar.

On April 15, 2018, Gabriela Zucman, submits her report to NorthStar's board. She finds the allegations in the blogpost to be false and misleading. The board welcomes Gabriela's findings and publicly releases her entire report the next day. NorthStar also announces that it has commenced action against the blogger (now identified) and SeekingAlpha.

Also, in Spring 2018, MedTech sets its sight on NorthStar. On April 2nd, it purchases 20% of NorthStar's outstanding shares from three shareholders, paying a 10% premium over the market value of the shares. On April 9th, it purchases another 3% of NorthStar's shares on TSX and also instructs its broker to purchase another 2% as soon as the markets open the next day. Noticing MedTech's increasing stake in NorthStar, Jeffrey calls William and asks if MedTech plans to acquire effective control. William responds that his company's plans are still too speculative and he cannot make any comments at this stage. However, to end the conversation on a positive note, William tells Jeffrey that he managed to get him a complimentary pass to Alex's new golf Club. On April 16th, MedTech enters into a contract with 10 of NorthStar's largest shareholders. They agree to tender their shares at a 25% premium over market value if MedTech makes a bid for NorthStar's shares within the next three months. The contract ensures MedTech's ability to acquire the shares even if a third party offers shareholders a better deal within the specified time frame.

In preparing the audits for the first quarter of 2018, Oliver & Young reviews NorthStar's prior financial statements for 2017 and identifies accounting deficiencies in them. It informs NorthStar that the 2017 statements need to be re-stated and that the interim filings for the first quarter will be also delayed. NorthStar immediately issues a press release announcing that the consolidated financial statements covering the period ended December 31, 2017, require restatement. Accordingly, it advises the public and investors not to rely on the financial statements, earnings releases, and the management's report on the effectiveness of the company's internal control over financial reporting relating to that period. On the day of announcement, April 20th, NorthStar's share price drops by 50% and Ramin Campos sells all the NorthStar's shares.

MedTech which now owns 25% of NorthStar, sees the downward pressure on NorthStar share price as a perfect opportunity to acquire complete control of the company. To finance the acquisition, MedTech enters into a third-party equity financing transaction with Canaccord, a financial services company, which purchases $100 million of MedTech's newly-issued securities. Canaccord also purchases 20,000 of NorthStar's shares on Monday, April 23rd.

On Tuesday, April 24th, MedTech sends a bid circular to NorthStar's shareholders, offering to acquire all issued and outstanding shares of NorthStar for a 15% premium over current market value. In its bid, MedTech raises the recent issues regarding the blogpost and the NorthStar's financial statements and warns that the downward pressure on NorthStar's share price could continue. It says the offeror believes that the consideration offered for the shares is a full and fair price. The bid gives the NorthStar shareholders until the last day of June to accept the offer. In the meantime, MedTech continues to strengthen its position by purchasing NorthStar shares on TSX. By April 30th, it has acquired an additional 4% of NorthStar outstanding shares at the current market value.

NorthStar's board considers the timing of MedTech's offer highly opportunistic and starts exploring the market for a better offer. Despite the board's persistent effort, no white knight is found. The board then engages in negotiations with MedTech, who agrees to increase the premium by 2% and maintain NorthStar's senior management team as consultants during the transition. MedTech issues an amended offer on June 5th, disclosing these changes. By the end of June, 90% of NorthStar outstanding shares have been tendered and MedTech seeks to take up the shares on July 1st.

Please advise on the securities regulation issues that arise in this matter.

Question Two: 30 Marks

Fairy Creek Brewery is a company governed by the *British Columbia Business Corporations Act.* It completes its first public offering of securities under a prospectus in 2012. The company's head office is located in Vancouver, BC. Fairy Creek is dedicated to brewing premium beers using only natural ingredients without any artificial flavours or preservatives. The company offers eight ales and lagers as well as an ongoing selection of seasonal beers. It ensures that its premium products reach its customers with maximum freshness and flavour by using state-of-the-art filtration and packaging technologies.

In early 2019, The company decides to establish a second brewery and signs a lease for a vacant warehouse in Big Rock. The company intends to commence brewery operations, together with restaurant and lounge operation in Summer 2020. It expects that the total expenditure for the new facility to be in the range of $3 million to $3.5 million, which it seeks to finance through selling new securities. On March 1, 2019, Fairy Creek offers its existing shareholders the opportunity to purchase more shares at a 20% discount to current market value. According to the offering circular, each shareholder of common share will receive one right per common share. Kamal and Lena, both holders of Fairy Creek's common shares, use this opportunity and each subscribes for an additional 1,000 shares on March 2nd. On April 1, 2019, both shareholders sell their newly acquired shares to Raj and Rosa, a married professional couple with a combined annual income of $200,000 in the last two years. Also later in March, Fairy Creek issues securities valued at $60,000 to Matin, owner of the warehouse, in return for the 2020-2021 rent.

On March 1, 2019, Fairy Creek grants an option plan, featuring a 20% market discount, to three members of its senior management team: Mark, the Chief Operating Officer; Bennet, Chief Financial Officer; and Robert, Vice President for sales and marketing. All three individuals exercise their options on March 5th, each purchasing 10,000 shares of Fairy Creek. Mark and Bennet regularly play golf at the Vancouver Golf Club, a prestigious private club home to many of Vancouver's high-net-worth residents. Learning about Fairy Creek's new facility, Ramin, and Madeleine, each invest $151,000 in the company's shares on March 15, 2019. Ramin is a long-term supplier of malt to fairy Creek and his business could substantially benefit from the opening of the new brewing facility. Madeline, who has just finished her MBA works in private equity. She goes to the golf club with her father, Chuck, a long-time friend of Robert and Fairy Creek's brewmaster since its inception. Madeline also tells her spouse, Kirstin, about Fairy Creek and she makes an investment of $200,000 in Fairy Creek's common shares. Kirstin is an investment banker with financial assets over $2 million. She finances her investment though a line credit which she has secured from Prime Capital, a new credit union in BC that seeks to attract customers by offering better lending rates than chartered banks. On June 1, 2019, Ramin sells the shares to his wife, Jocelyn.

On May 1, 2019, Fairy Creek conducts another capital raise, this time selling securities to Canadian Tire Bank, a schedule I bank regulated by the Office of Superintendent of Financial Institutions, and Acumen Capital, a registered investment dealer. Each institution purchases $200,000 in Fairy Creek's common shares. On July 1, 2019, Canadian Tire sells the shares to Acadia Financial a registered mutual fund dealer. On September 15, 2019, Howard, a retired high school teacher, purchases all the shares from Acadia at a bargain price of $151,000.

Finally, on July 1, 2019, Fairy Creek issues convertible preferred shares valued at $50,000 to Progressive, an insurance company. On August 1, 2019, Progressive converts the preferred shares to common shares. On October 10, 2019, Progressive sells the shares at the same price to Mahmood Shahbaz, an unemployed single young man who borrows the money from his parents.

Please advise on the application of the exempt market rules in this matter. Please assume that all investors purchase securities as principal. Assume also that there is no control block distribution.

END OF EXAMINATION