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Private Financing of Entrepreneurships: Sources of Private Financing; Guarantees (Required Personal or Otherwise); When to Go Public (Pros and Cons); Rights of Financing Parties; Defaults; Capital Formation for Entrepreneurial Ventures; Tax Considerations

Discussion

program – here is a world leading company that is a real success in its own backyard coming to North America to establish operations here.

We see daily in the papers about wanting to establish solar parts. The LPA and government have brought in new incentive programs to help us establish solar technology.[73] It bodes well and provides for some opportunities cross-border between Canada-U.S. We are bringing this world-class technology from another jurisdiction, into North America, while at the same time going public and having access to the public markets here.

DISCUSSION FOLLOWING THE REMARKS OF MORTON A. COHEN AND DAVID WOOLFORD

MR. ROBINSON: Well, Henry and everybody else will be pleased to know that we have 22 and-a-half minutes left for questions, which is terrific. I would just like to say one thing before we do questions.

MR. WOOLFORD: Let me just ask one thing about SPACs. I recall, and maybe it was more than five, ten years ago, there was a similar type of program in the U.S., which initially garnered a lot of interest, but then I think it garnered some bad press as well. Either they were not making a lot of investments or the investments they were making were less than sterile quality and caused a lot of dissatisfaction, or caused the program to run into a lot of lack of interest because of that.

MR. COHEN: I will go back to my initial statement – that investment bankers in this country are extremely creative. They have come up with a different structure, which precludes these blank check companies from just making any old acquisition. The way this thing works is that the money is raised on certain conditions. One of those conditions is that 85 percent of the funds go into escrow, at which point you have 18 months to make an acquisition, supposedly within the domain of your prospectus. If 80 percent of the shareholders vote against this, they cannot approve the acquisition. If somebody wants to get their money out after the 18 months, they can get their money out of that program, minus the 15 percent that the investment bankers get.

So the structure is different, and it is supposed to be more protective. There are also warranties that go into these deals, and interestingly enough, the warranties are at the issue price and sometimes less than the issue price. It is not all worked out.

MR. ROBINSON: Dr. Barber had the first question, I believe.

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[73] *See generally* Government Incentives, The Canadian Solar Industries Association, http://www.cansia.ca/government.asp (last visited Oct. 16, 2007) (describing Canadian Federal, Provincial and Municipal incentives for the installation of solar technology).

DR. BARBER: David, help me understand why the venture capitalists in Virox would want to get out of such a successful story?

MR. WOOLFORD: That is a very good question, Doug. And the fact is that they did not want to get out. I was with a company called Canadian General Capital, a very successful company, much more so in the larger investments. We were the only investment in their microcap that actually made money, and they invested about $2.5 million, and we returned about $5.6 million. So, the venture capitalists did well from 2000 to 2005, but they had two main stakeholders: The Power Pension Fund and the Hydropension Fund and HOPF, the Hospital Pension Fund. And when the power generation facility in Ontario split into three, they essentially disbanded the source of funding for this particular venture capital fund and were ordered, over a span of two or three years to liquidate the funds.

So, Virox was the venture capitalists' last investment, and they would have loved to have held on, but it was not large enough for the pension funds. Either it would have been split 50-50 and then distributed right to the funds, or as we wanted to do, have a buyout. This was a good question, because if they were still around, I am sure they would still want to be in as an investor.

They did not have any rights, which was quite unique, but at the same time, we could only buy them out if they agreed to our price. It was a good return for them, and since they were in liquidation mode, they let us in.

MS. LILLEY: This is a question for Mr. Cohen. I wondered if you had a view as to the structure auction market that the investment bankers seem to have created, as well as some of the other things you created.

MR. COHEN: That is a product I really don't know that much about. And I really do not want to comment because I have not been involved in it. What I wanted to touch on, because I think it is interesting, is that we have another development in the American scene. We have these Chinese companies going public in the United States by using a shell vehicle and becoming a U.S. company where the stock is only traded in the United States.

Similarly, in Canada, you have many Chinese companies that are now traded only in Canada and have become Canadian companies. I do not know what this does to entrepreneurs in the United States and Canada. I will say that it diverts money out from an entrepreneurial company here to the Chinese companies.

This market is really growing. I am going to China in four weeks, and I believe that the number of companies that you are seeing in Canada are the smaller kind, and in China they are getting larger companies.

MR. WOOLFORD: I have been working, as I mentioned, on a program to bring companies from Germany public in Canada for the last two years. The real driving force is the international banking accord that many of the

European countries entered into, called Basel II,[74] in the last year or two, which significantly restricts access to capital in German companies unless they are public.[75] The problem is that the only exchange that is worthy to note in Germany is the Frankfurt Exchange, and you essentially have to be a company that has a market capital of $1 hundred million Euros or above in order to be able to garner interest and go public on that exchange.

By taking them public on the Venture Exchange in Canada, you can apply for an inter-listing on the Frankfurt Exchange and secure it that way without having to meet the significant monetary criteria that many or most of those companies can't meet and will never be able to meet. So it is a very attractive feature that way.

MR. ROBINSON: Why do they not list on the AIM in London?

MR. WOOLFORD: The AIM is probably the largest competitor to the Venture Exchange. The AIM is at least three times more expensive and has been fraught with some problems. There have been some success stories. Sandvine Waterloo, which was a spin-off from Pick Stream, sold out to Cisco at a hugely significant multiple in the half billion-dollar range, they went public on the AIM about 12, 18 months ago.[76] They had $15 million on the top line, and a $3 million loss on the bottom line the first day, and their market was doubled.[77] They have recently started taking off again, and they are starting to get significant traction in the marketplace.

I was trying to steer our chief officer to at least consider AIM for Virox, but he does not want to be a public company. We believe our exit will be through our strategic partners. AIM was garnering significant interest and some significant multiples, and I was telling management of Virox to at least explore it because it could represent some considerable liquidity. But, the chief officer just has no interest in being a public company.

MR. ROBINSON: Well, if there is no hand up for a moment, I will just make a brief comment about the AIM. Our office does quite a bit of work in the mining game, and we find a lot of our mining clients - Canadian mining clients - who would seemingly be interested in the Toronto listing, which

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[74] *See generally* Basel II: Revised International Capital Framework, Bank for International Settlements, http://www.bis.org/publ/bcbsca.htm (last visited Oct. 16, 2007) (describing the framework of Basel II).

[75] *See generally* Basel II: International Convergence of Capital Measurement and Capital Standards, Bank for International Settlements (2004), http://www.bis.org/publ/bcbs107a.pdf (establishing higher risk ratings for corporations that are not public).

[76] *See generally* About Sandvine, Sandvine Inc., http://www.sandvine.com/about_us/default.asp (last visited October 16, 2007) (describing Sandvine's listing on the Toronto Stock Exchange ("TSX") and London Stock Exchange "AIM").

[77] *See generally* Stock Market Quotes: Sandvine Corporation, TSX Group, http://www.tsx.com/ (enter "SVC" in Get Quote box) (last visited Oct. 16, 2007) (showing performance of Sandvine stock since its listing in October 2006).

traditionally was one of the best exchanges in the world for mining companies. Rather, they wanted to list on the AIM. So we have to do a joint venture with an AIM expert.

MR. WOOLFORD: I would love to have that capability in-house to advise our clients to consider a venture exchange or another listing, but as I said, I have not had anybody that wanted to explore that option. I think it is a tremendous competitive advantage for your firm and it certainly shows a lot of foresight.

MR. ROBINSON: They have that wonderful tradition in England where they have regular principles, the main principle being if you do not behave, you will not be spoken to at the club.

MR. WOOLFORD: One of our CPC clients from Montreal has a really neat idea. There is a lot of technology being developed these days in waste management systems, particularly the systems that apply significant amounts of heat to change the waste, whether it be energy or other types of materials, in order to re-circulate it back into the environment. This client had an abortive, and a very distressing experience with the AIM, and it has cost them $900,000, and they are just starting to return from it. I am not sure if they had the best banking advice on the investment side, and perhaps were a bit naive in some other things. Nevertheless, it is like trying to take a company out and doing a full blown IPO, whether it be in Canada or the U.S., and then finding out that either the story was not well received or market conditions changed, and you are faced with significant dollars.

That is where something like the CPC program or the SPAC program has a lot of advantages that can dispel, or temper, those negatives.

MS. LUSENBURG: Some of the comments this morning about socially responsible investing and ethics in the context of the entrepreneurial community, I think it was Doug Barber that said the cost of governance, legal barriers, or compliance is significant when you are small operations. That is a problem. You do not have time for a lot of lawyers and people running around putting the right structures in place. So you are perceived to be under the coalition of good governance and it is an issue that increasingly comes forward. Do you have good principles, ethics? When you are an entrepreneur, a little guy, how do you deal with that, and with your clients? How do you bring that to the point of maturing? They have the right process but do not have the luxury or the vigor to do what they want. They are in a Catch-22 because you may not be attractive, and from my perspective, we do not do a lot of venture fund investing, but those are issues we look at. How do you get them there?

MR. COHEN: I could answer, but quite briefly and I am sure if it was addressed, I think the major thing that they are looking at is management. I do not quite agree with Mal Mixon. You have to look at the management and look at the integrity of management, and you have to decide whether it has a social conscience. Can you make management have social conscience? That depends on the board of directors. I think the end result is that you will have a responsible management and entity.

MR. WOOLFORD: I would add from a professional advisory perspective that you can if you are prepared to put in the time. It is certainly a hallmark of my practice to help coach and advise these companies, whether I am an advisory board member or board member, I am spending a lot of time – beyond billable hours – and generating considerable legal fees, so the return is more than rewarding, because I believe in these companies, and many of them have turned out to be very good success stories. You really have to invest in the relationship, even if it means using your own personal time.

Picking up on the point that Morton mentioned, if you are dealing with a company that has management with unquestionable integrity, sound management, good strategic vision, and for which you cannot guarantee a rate of success of more than 50 percent. They will be a success, then you can distill those values, and you can work with them and spend the time and help make that part of the culture. You are not sort of docketing and charging them for all that because you are essentially enhancing your own client base as well.

MS. DOBREA: Question for David, what was the origin of the technology for your Virox company? What role did intellectual property play, particularly patent, if any?

MR. WOOLFORD: That's a very good question, and it is actually a very interesting and somewhat anxiety-ridden story. I first met the mad scientist. He is no longer with the company, but on the venture capital round, he and his wife got $500,000 paid to them, which is almost unheard of, so it was a good deal. Over the course, they received more than a million dollars so they did quite well. I first met him through a contact at the Royal Bank, and he had heard that a fellow had few hundred thousand dollars on deposit. The company must be doing pretty well. You should go talk to him about being a client.

When the banker first went to see him, he hated bankers, and when I first went to see him, he hated lawyers. It took many greasy spoon restaurants and breakfasts and many conversations to get into his comfort zone, and then he said he was being courted by a group that he called the piranhas that wanted to buy him out, and ultimately, I introduced him to Randy, and he took a shine to Randy.

Randy wrote a business plan, and then the three of us got together, and we received a million dollars. Life was good, and we went to the venture capital financing and got him a half million dollars, and he was going to be the chief science officer. No sooner had the ink dried and the deal closed – all of a sudden he decided he wanted to run the company again and did not care what the agreement said and basically wanted his gas card back. We had some interesting issues and had to ultimately iron them out.

Coming back to your question, he would not let anybody see the technology. In retrospect, we should have gotten access to the technology and done a technological assessment, but other than to show Randy all we had was four or five patents and several in the hopper. It was like your grandma's favorite muffin mix, and you had four, five, or six different ingredients, all of which you could go to your kitchen or anybody's kitchen, and you would all have those ingredients. It was unique, because of the way they were mixed and matched and how they were applied and at what temperatures. We think that he just fell on it. We were mortified because there was a paper that was published in a journal that looked like it came out about the same time that we first applied for the patent. We had to go to the publisher, and we had to get evidence and affidavits with the actual time issues. You know, the typical way the press comes out, they will say January of 2007, but the thing actually was December something, and it became really critical.

The other reason we think he just happened on it is because there is a group in Ontario called Ortech, which was a government funded research development agency. At this agency you could bring certain products, and you could get subsidized testing. This guy was a mad entrepreneur because he wanted to develop a liquid detergent that could compete against Tide. They priced it out and figured it was $25,000. A few weeks into the test, they called him up and said we have done half the test and your product has failed miserably against Tide, and did he want them to continue. He decided not to continue, but he was just the kind that would tinker, and we think that ultimately he arrived at something, which spawned into a multi-billion dollar business.

It is a goodwill story, but when I look back at it and look at the risk profile, that if we were not able to secure the patent or if it turned out he had pilfered some of those ingredients, we could be out of business and would have been out a lot of investment money. It worked out for the best, but when you look back and say should I, as a lawyer, have done something differently, he never would have allowed us in. Had we not insisted upon that, we never would have done the deal. We would have walked and done something else.

I think it was lockup with Mal. There is some luck involved, but certainly since then, there has been a lot of value and top notch management and direction.

MR. COHEN: I have a question for the panel. One is, I do not think, and it has not been mentioned, what are the status of flow-through shares and flow-through vehicles available in Canada?

MR. ROBINSON: They are still around.

MR. COHEN: The second thing is, maybe with Canada, is the immigration policy. It has now been the source of a lot of creativity in entrepreneurship, and it is distinct from policies that we are not developing.

MR. WOOLFORD: Michael, you are the most esteemed member on our panel, so I will turn to you quickly on this question.

MR. ROBINSON: Quickly then, as you know, we do not have immigration quotas. We have a point system that is based on a number of things, including language skills, educational levels and ability to contribute, et cetera.

We do find that we are getting good quality immigrants. When Selma and I were practicing together years ago, a wonderful Russian immigrant – who, in effect, invented liquid ice – allowed certain prospective partners to come in and look at the technology. They all signed non-disclosure agreements, and then we found that they had taken out 14 patents in Japan based on his stuff. Fortunately, we caught them, and they agreed to assign the patents back.

Obviously, this can be a huge problem unless you have your patent base registered all over the world. This was a Japanese partner, and he did not register in Japan, and they just scooped him.

To answer the first question, flow-throughs are still around. I am certainly not a tax lawyer, but I know that people are trying to sell them to me all through December. It is like a trust or a partnership where the profits all flow directly to the investor, the shareholder. They are usually accompanied by wonderful incentives, in order to stimulate mining exploration, oil, gas in the far north. It was good in the old days but not so much any more.

MR. COHEN: Well they get a better tax break.

MR. ROBINSON: Oh, yeah, sure.

MR. COHEN: That is the incentive.

MR. ROBINSON: What occurs is that the government subsidy flows directly through to you as the shareholder so you could invest $10,000 and get a $12,000 tax write-off.

MR. WOOLFORD: One last comment around this German company, the solar tech company, although the volumes are not big enough yet, but with the Kyoto Accord and the carbon credits, we have been looking strategically and possibly a flow-through investment that includes the share and portion of the carbon credit that this company can develop.

MR. ROBINSON: Great idea. Sell them in China. Thank you very much panelists.