

White Paper on Canadian Issuers Planning to Seek Admission to Trade on OTCQX/OTCQB

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Disclaimer

This document is not intended to be construed as legal advice.

IRS Circular 230 Disclosure: To ensure compliance with requirements imposed by the Internal Revenue Service, any United States federal tax disclosure contained in this document is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code; or (ii) promoting, marketing, or recommending to another party any transaction or matter addressed in this document.

What Is The OTC?

OTC Markets Group Inc. (OTCQX: OTCM) operates an electronic inter-dealer quotation and messaging system that facilitates trading in over 10,000 US and global securities in all major industries, including metals and mining, financial services, oil & gas, utilities, telecommunications, media, pharmaceuticals and biotechnology. Through its OTC Link® ATS (Alternative Trading System), OTC Markets Group links a large network of broker-dealers that provide liquidity and execution services.

OTC Markets Group organizes the market into three marketplaces based in large part upon the quality and quantity of the information that the participating companies make publicly available, and the degree of each company's investor engagement. The three marketplaces, in descending order of the transparency of the participating companies, are: the OTCQX® marketplace, the OTCQB® marketplace, and OTC Pink® marketplace.

OTCQX

The OTCQX marketplace is the top-tier of the marketplaces operated by OTC Markets Group. To qualify for the OTCQX marketplace, companies must meet high financial standards, demonstrate compliance with US securities laws, and be current in their disclosure. They must also be sponsored by a qualified professional third-party advisor - known as a Designated Advisor for Disclosure (DAD) for US domestic companies, or a Principal American Liaison (PAL) for foreign companies. Eligibility for acceptance by OTC Markets Group as a DAD is limited to experienced and qualified securities attorneys or investment banking firms that are members in good standing with the Financial Industry Regulatory Authority, Inc. (FINRA). PAL eligibility is limited to reputable and qualified securities attorneys, FINRA member investment banking firms or ADR depositaries.

Foreign companies seeking admission to trade on OTCQX must choose between two sub-tiers, namely, OTCQX International Premier and OTCQX International. Both platforms are designed to meet the needs of foreign public companies by providing a marketplace in the US that offers many of the benefits of traditional US stock exchanges with lower regulatory and reporting costs. OTCQX International Premier is designed for larger blue-chip companies and requires applicants to meet more stringent financial qualification standards in addition to the requirements prescribed for all other OTCQX International companies.

OTCQB

The OTCQB marketplace is the middle marketplace and was developed for venture-stage companies that do not qualify for admission to trade on the OTCQX.

OTCQB companies must be current in their disclosure and must meet a minimum US\$0.01 bid price test. OTCQB companies are also subject to an annual verification and

management certification process. If the company is seeking quotation on the OTCQB as an “International Reporting Company” not subject to Securities and Exchange Commission (SEC) reporting requirements, it will have to submit with its application for admission a letter of introduction from a PAL.

OTC Pink

OTC Pink is the lowest marketplace, and provides investment opportunities which are subject to greater – and in some cases, very significant - risk. It serves as an open marketplace for brokers for trading all types of companies without necessarily requiring company involvement. OTC Pink companies typically have the lowest level of engagement with investors, and include foreign companies that limit distribution of company information to their respective home markets.

There are no minimum financial standards and companies quoted on OTC Pink include penny stock issuers, shell companies, and delinquent, dark, financially distressed and bankrupt companies. Therefore, investment requires extra caution and higher risk controls by brokers and investors. Given the variability and inconsistency of reporting among OTC Pink companies, OTC Markets Group segments them into those that provide current information, limited information, and no information.

Why Should a Canadian Issuer Consider the OTCQX/OTCQB?

US capital markets are one of the world’s leading and most consistent markets to provide issuers with access to capital and liquidity for shareholders. They have long been a favored destination for Canadian companies wishing to raise capital or establish a trading presence for their securities.

Historically, Canadian companies have preferred listings on US national securities exchanges, such as the New York Stock Exchange, the NYSE MKT or the NASDAQ Stock Market. While these stock exchanges continue to be excellent platforms for certain companies, many companies have become concerned over the scope, effects and related compliance costs of ongoing “regulatory creep” under the *Securities Exchange Act of 1934 (Exchange Act)* on US-listed companies following the enactment of the *Sarbanes-Oxley Act of 2002*.

In response the SEC has introduced significant regulatory changes that have made the OTCQX substantially more attractive as an alternative US capital market for more senior Canadian and other non-US companies. At the same time, innovations introduced by OTC Markets Group in connection with the reorganization of the OTC market have established the OTCQB as a transparent and viable trading platform for venture stage companies which cannot qualify for listing on a US national securities exchange or the OTCQX.

- **Compliance with US Securities Law:** Qualifying Canadian public companies can rely on the exemption in *Exchange Act* Rule 12g3-2(b) (discussed below) from the registration and reporting requirements of the *Exchange Act*, which allows these companies to trade on OTCQX or OTCQB.
- **Liquidity:** In most cases, unrestricted securities may be purchased and sold on OTCQX or the OTCQB through US registered broker-dealers in the same way that similar securities are traded on US national securities exchanges such as the NYSE and NASDAQ. Assuming that Rule 144 under the *Securities Act of 1933* (*Securities Act*) is available to facilitate resale transactions in a Canadian public company's restricted securities, admission of the company's shares to trade on OTCQX or OTCQB might also enhance US investor interest in unregistered private placement offerings by the company by providing an organized US market through which the shares could eventually be resold.
- **Lower Costs:** Seeking admission to trade on OTCQX or OTCQB is significantly more cost effective and time efficient for Canadian public companies than seeking listing on a US national securities exchange which requires not only the submission of a stock exchange listing application but also *Exchange Act* registration with the SEC.
- **No Need for a US Base:** A company is not required to have any US operations to seek admission to trade on the OTCQX or OTCQB, and there are no US residency requirements for directors or officers.
- **Tax Consequences:** Admission of a Canadian public company's shares to trade on the OTCQX or OTCQB in and of itself does not trigger any US tax consequences for the company. However, an investment in the company's securities may give rise to US tax consequences to US investors. Therefore, they should consult their tax advisers before entering into any such transaction.
- **Time:** Foreign companies that satisfy the requirements of the OTCQX International marketplace and avail the exemption from *Exchange Act* registration under *Exchange Act* Rule 12g3-2(b) can complete the initial admission process in as little as four weeks. However, *Exchange Act* Rule 15c2-11 and FINRA Rule 6432 require, among other things, that a market maker file a Form 211 with FINRA's OTC Compliance Unit before quotations in the company's stock may commence; clearance of the Form 211 by FINRA can sometimes result in some delays in the OTCQX admission process. Overall, admission to trade on OTCQX International takes significantly less time than the process of registering a company with the SEC under the *Exchange Act* and applying for listing on a US national securities exchange.
- **Transparency:** OTC Markets Group provides Real-Time Level 2 quotes for OTCQX and OTCQB companies. OTC Markets Group also runs the OTC Disclosure & News Service to assist investors, even for companies that are not subject to reporting obligations under section 13(a) of the *Exchange Act*.

What are the requirements for listing on the OTCQX/OTCQB?

OTCQX

To be admitted to OTCQX International, a foreign company must satisfy the requirements below:

- **Financial Criteria** – As of the most recent annual or quarterly period end, the company must have US\$2 million in total assets and satisfy one of the following quantitative requirements as of the most recent fiscal year end: (a) US\$2 million in revenues; (b) US\$1 million in net tangible assets; (c) US\$500,000 in net income; or (d) US\$5 million in global market capitalization.
- **Listing on a Qualified Non-US Stock Exchange** – The company must be listed on a Qualified Foreign Stock Exchange, such as the Toronto Stock Exchange (TSX), the TSX Venture Exchange (TSXV) or the Canadian Securities Exchange (CSE), for at least 40 days.
- **SEC Registration or Rule 12g3-2(b) Eligibility** – The company must either (1) have a class of its securities registered under section 12(g) of the *Exchange Act*, or (2) be eligible for the exemption from *Exchange Act* registration provided by Rule 12g3-2(b). Reporting issuers under Canadian provincial securities legislation that post their continuous disclosure documents on SEDAR will generally qualify for the Rule 12g3-2(b) exemption, provided that they (1) continue to qualify as a “foreign private issuer” as defined in *Exchange Act* Rule 3b-4 and (2) maintain a listing one or more exchanges outside the United States that, either singly or together, constitutes the primary trading market for the issuer’s securities.
- **Price Quotation** – The company must have proprietary priced quotations published by a market maker in OTC Link.
- **Blue Sky Manual Exemption** – The company must be included in a recognized securities manual, such as those published by Standard and Poor’s or Mergent (formerly Moody’s), and thereby maintain eligibility for the so-called “manual exemption” from “blue sky” registration requirements that is available in 38 states to facilitate secondary trading in the company’s shares.
- **Appoint a Principal American Liaison (PAL)** – The company must appoint a PAL sponsor to help with the admission process, provide advice with respect to the company's compliance with *Exchange Act* Rule 12g3-2(b) (if applicable), conduct an annual review of the company's posted disclosure and assist with responses to requests and inquiries from OTC Markets Group.

Application Process

- **Application** – In order to join OTCQX International, the company must complete an OTCQX Application for International Companies. This application requires information concerning the company, the securities to be quoted and the company’s compliance with OTCQX International eligibility requirements.
- **Agreement** – The company also must enter into an OTCQX Agreement for International Companies. Among other things, this agreement provides for the

designation of the company's securities as OTCQX International securities and requires the company to post its Canadian continuous disclosure documents on the OTC Disclosure and News Service.

- **Fees** – The company must pay a non-refundable application fee of US\$5,000 at the time it submits the OTCQX Application to OTC Markets Group, and pay an annual fee of US\$15,000 (pro-rated for the first year).

OTCQB

To be admitted to OTCQB, a foreign company must satisfy the requirements below:

- **Price Quotation** – The company must have proprietary priced quotations published by a market maker in OTC Link.
- **Bid Price Test** – The company must meet an initial bid price test of \$0.01 as of the close of business for each of the previous 30 calendar days.
- **No Bankruptcy or Reorganization** – The company must not be subject to bankruptcy or reorganization proceedings.
- **SEC Registration or Rule 12g3-2(b) Eligibility** – The company must either (1) have a class of its securities registered under section 12(g) of the *Exchange Act*, or (2) be eligible for the exemption from *Exchange Act* registration provided by Rule 12g3-2(b). As discussed above, most Canadian public companies listed on Canadian stock exchanges will qualify for the Rule 12g3-2(b) exemption.
- **Listing on a Qualified Non-US Stock Exchange** – If the company is not registered under section 12(g) of the *Exchange Act*, it must apply for admission as an “International Reporting Company” which:
 - is compliant with *Exchange Act* Rule 12g3-2(b); and
 - is, and has been for at least 40 days, listed on a Qualified Foreign Stock Exchange, such as the Toronto Stock Exchange (TSX), the TSX Venture Exchange (TSXV) or the Canadian Securities Exchange (CSE).
- **Appoint a Principal American Liaison (PAL)** – If the company is not registered under section 12(g) of the *Exchange Act* and is applying for admission as an International Reporting Company, it must appoint a PAL sponsor to help with the admission process and provide a “Letter of Introduction” together with the company’s application for admission which confirms that the company is listed on a Qualified Foreign Exchange, and in which the PAL states that it has a reasonable belief that the company is in compliance with *Exchange Act* Rule 12g3-2(b).
- **Disclosure** – The company must post on the OTC Markets website: Previous two years’ of disclosure required under *Exchange Act* Rule 12g3-2(b) in English (except press releases), and its OTCQB Initial Certification (see below for details on Certification requirements).

Application Process

- **Application and Agreement** – In order to obtain an OTCQB quotation, the issuer must complete an OTCQB Application and Agreement. This application

- requires information concerning the issuer, the securities to be quoted and the issuer's compliance with OTCQB eligibility requirements.
- **Application Fee** – A company must pay a non-refundable application fee of US\$2,500 at the time the company submits its OTCQX application to OTC Markets Group and an annual fee of US\$10,000.

Compliance with US Securities Law

An issuer is generally required to register a class of equity securities with the SEC under the *Exchange Act* when it has over US\$ 10 million in total assets and the class is held by more than 2,000 shareholders of record or 500 shareholders of record who are not accredited investors (as defined in Rule 501(a) of Regulation D under the *Securities Act*), subject to:

- the exemption available under *Exchange Act* Rule 12g3-2(a) to “foreign private issuers” (see below) where the class of equity securities is held by less than 300 US residents; and
- the exemption available to certain foreign private issuers under *Exchange Act* Rule 12g3-2(b).

If a Canadian public company that qualifies as a foreign private issuer is required to register under the *Exchange Act*, it will become subject to periodic reporting requirements under section 13(a) of the *Exchange Act*, namely:

- the requirement to file annual reports with the SEC on Form 20-F or Form 40-F, if available, and
- the requirement to furnish to the SEC on Form 6-K (1) its Canadian continuous disclosure documents that it posts on SEDAR, (2) any materials that it files or is required to file with a stock exchange on which its securities are traded and which was made public by that exchange, or (3) any materials that it distributes or is required to distribute to its security holders.

In addition, beneficial owners of more than 5% of the company's equity securities will become subject to the requirement to file beneficial ownership reports on Schedules 13D or 13G under section 13(d) of the *Exchange Act* and *Exchange Act* Rule 13d-1.

Most Canadian public companies that are admitted to trade on the OTCQX or OTCQB will qualify as foreign private issuers, and for the exemption from *Exchange Act* registration available under *Exchange Act* Rule 12g3-2(b). The SEC adopted amendments effective October 10, 2008 which make the exemption under *Exchange Act* Rule 12g3-2(b) self-executing, without the need to make application to the SEC.

In order to be eligible to rely on the exemption from registration under *Exchange Act* Rule 12g3-2(b), the issuer must meet four requirements:

1. Issuer must be a “foreign private issuer”

“Foreign private issuer” is defined in *Exchange Act* Rule 3b-4 to mean any foreign (non-US) issuer (except a foreign government), *except* an issuer meeting the following conditions as of the last business day of its most recently completed second fiscal quarter:

- more than 50% of the issuer’s outstanding voting securities are directly or indirectly held of record by residents of the United States; *and*
- any of the following:
 - the majority of the issuer’s directors or executive officers are United States citizens or residents;
 - more than 50% of the issuer’s assets are in the United States, or
 - the issuer’s business is administered principally in the United States.

2. Not registered with the SEC

The issuer must not be an *Exchange Act* registrant, and the issuer must not be required to file reports with the SEC under section 13(a) or 15(d) of the *Exchange Act*.

3. Listing on a “primary trading market” outside the US

The issuer must maintain a listing of its securities on one or more non-US exchanges that, either singly or together, constitute the primary trading market for its securities.

To have a non-US primary trading market, at least 55 percent of the trading in the securities on a worldwide basis must have taken place during the issuer’s most recently completed fiscal year in on or through the facilities of the securities markets in not more than two foreign jurisdictions. If the issuer aggregates the trading of the securities in two foreign jurisdictions for purposes of the test, the trading for the securities in at least one of the two foreign jurisdictions must exceed the US trading for the securities.

There is no minimum time period for which securities need to be traded in the primary trading market to qualify for the Rule 12g3-2(b) exemption. Therefore, an IPO issuer can satisfy the exemption, although, as discussed above, an OTCQX International issuer must have a pre-existing listing on a Qualified Foreign Stock Exchange.

4. Publish English-language versions of Non-US Disclosure Information

The issuer must publish, in English, information that, since the first day of its most recently completed fiscal year, it has:

- Made public or been required to make public pursuant to the laws of its country of incorporation, organization or domicile,
- Filed or been required to file with the principal non-US stock exchange on which its securities are traded and which has been made public by that exchange, and
- Distributed or been required to distribute to its security holders.

The information must be published by the issuer either on its internet website, or through an electronic information delivery system generally available to the public in its primary trading market, such as SEDAR.

Why McMillan?

McMillan is a leading Canadian business law firm serving public, private and not-for-profit clients across key industries in Canada, the United States and internationally. With offices located in Vancouver, Calgary, Toronto, Ottawa, Montréal, and Hong Kong, the firm provides complementary product offerings creating numerous opportunities for cross-collaboration and expansion.

McMillan's Capital Markets Group is a leader in enabling clients to access US capital markets. Our team includes lawyers qualified in the United States who can advise on a complete range of US securities matters, including public and private securities offerings, listings on US national securities exchanges (including the New York Stock Exchange, the NYSE MKT and the NASDAQ Stock Market), admission to trading on the OTCQX and OTCQB, and SEC regulatory compliance. When required, we assemble teams comprised of lawyers who understand cross-border issues including corporate finance, tax, mergers and acquisitions, corporate governance, and other day-to-day business issues.

Engaging McMillan provides our clients with the advantage of working with one firm—a firm with a singular culture that promotes excellence, collaboration and cross-practice integration. A one-firm approach, versus working with separate firms in each country, can help to improve timeliness and reduce costs. We have participated as lead US counsel for issuers and underwriters in cross-border unregistered private placement offerings effected in reliance on Rules 506 and 144A under the *Securities Act*. We have also acted as US counsel to issuers in connection with offerings which have been registered under the *Securities Act* on Forms S-1, F-1, S-3, F-3, F-10 (under the Multi-Jurisdictional Disclosure System) and S-8, as well as mergers & acquisitions or reorganization transactions that have been effected in reliance on the registration exemption in section 3(a)(10) of the *Securities Act*, or registered with the SEC on Forms S-4 or F-4 under the *Securities Act*. Our US securities team includes:

Michael Taylor

Michael is Co-Chair of McMillan's US Securities Practice Group, based in the firm's Vancouver office. He advises a broad range of technology, industrial and resource companies that are traded in Canada on the TSX and TSX Venture Exchanges, in the United States on the NYSE MKT and the OTC marketplace, and in Hong Kong on the Hong Kong Stock Exchange Mainboard. Michael is admitted to the Bar in British Columbia and Nevada.

Herbert (Herb) I. Ono

Herb is Co-Chair of McMillan's US Securities Practice Group and its Japan Practice Group, and is also based in Vancouver. He has a varied cross-border corporate finance and securities practice. He routinely assists clients in negotiating and implementing mergers and acquisitions, corporate spin-offs, and public and private financing transactions. His experience includes advising publicly-traded clients on corporate governance, *Sarbanes-Oxley Act* compliance, Canadian and US securities filings, and stock exchange listings. Herb's

experience includes acting as US counsel on registered business combination transactions and public offerings under the *Securities Act*, unregistered private placement offerings under the *Securities Act*, continuous disclosure filings under the *Exchange Act*, and listings on the NYSE and NYSE MKT. Herb is admitted to the Bar in British Columbia, Ontario and California.

Daniel Dex

Daniel, based in McMillan's Vancouver office, provides US securities law advice to a broad range of companies. Daniel routinely assists clients in public and private financing transactions, mergers and acquisitions, and compliance with their on-going disclosure requirements under the *Exchange Act*. In addition, Daniel provides advice on corporate governance issues, including compliance with the *Sarbanes-Oxley Act*. His experience also includes assisting clients with exchange listing applications and cross-border migrations. Daniel's experience includes acting as US securities counsel on registered public offerings under the *Securities Act* (including ATM offerings), unregistered private placement offerings, and mergers and acquisitions. Daniel is admitted to the Bar in British Columbia and New York.

Michael Shannon

Mike, based in McMillan's Vancouver office, is experienced in general corporate and securities related matters and provides Canadian and US securities law advice to a broad range of companies that are listed in Canada and the United States. Mike assists companies with their formation, structuring, financing, listing, disclosure requirements, corporate governance, strategic alliances, mergers and acquisitions, cross-border transactions and migrations. Mike frequently assists companies in complying with their on-going reporting obligations under the *Exchange Act* and with the registration of securities under the *Securities Act*. Mike also represents private companies and provides them with general corporate and securities related advice. Mike is also experienced in securities registration matters and assists clients with registration and compliance under National Instrument 31-103. He is admitted to the Bar in British Columbia, Alberta and Kansas.