

**ALBERTA SECURITIES COMMISSION
STAFF NOTICE**

SALE OF UNDIVIDED INTERESTS IN LAND

April 17, 2002

On March 28, 2002, the Commission released its decision *In the Matter of the Land Development Company Inc. and Phil Archer* (the "Decision"). The Decision concluded that certain undivided interests in land constituted "securities" as defined in the Act because they fell within the definition of "investment contracts". Consequently, the sale of those undivided interests in land was a "distribution" under the Act and was required to be made under a prospectus and by a dealer registered under the Act or pursuant to exemptions from the prospectus and registration requirements.

Staff is aware that there are a number of persons or companies offering undivided interests in land for sale. Persons or companies involved in the sale of undivided interests in land (or other real estate securities) should review those offerings, in light of the Decision, to determine whether they are offering securities for sale.

The Decision states that "although it is well established that a simple sale of real estate, whether for investment or personal occupation, is not a 'security' under the Act...if the sale of real estate includes collateral arrangements through which the purchaser may earn a return on income through the managerial efforts of a promoter or manager in their operation of the enterprise associated with the real estate (such as rental pool agreements, cash flow deficiency guarantees or rental management services), such transactions are generally characterized as investment contracts" and are therefore securities.

If a seller concludes that it is selling securities, those interests can only be traded in compliance with the Act and the Rules. This means that the seller must either comply with the prospectus and registration requirements of the Act and Rules or rely on exemptions from those requirements. There are a number of exemptions in the Act and the Rules including those in Multilateral Instrument 45-103 *Capital Raising Exemptions* ("MI 45-103"). MI 45-103 contains a number of new exemptions, including an exemption that allows an issuer to sell an unlimited number of securities to the public provided that each investor obtains an offering memorandum in a prescribed form and completes a risk acknowledgement form. Investors under the offering memorandum have certain rights of action if the offering memorandum contains a misrepresentation.

Sellers of undivided interests in land should turn their attention to this matter as soon as possible. We recommend that sellers review the Decision and contact professional advisers to consider the issue in detail. There is a considerable body of case law on the question of what constitutes an investment contract. We cannot provide legal advice nor can we set out all the criteria that a seller should consider in determining whether the interests it proposes to sell are investment contracts and therefore securities. However, at a minimum, the seller should ask itself:

Is this a contract, transaction or scheme whereby a person invests his money in a “common enterprise” and is lead to expect profits (i) solely from the efforts of the promoter or a third party, or (ii) if not solely from the efforts of a promoter or third party, then the efforts of the promoter or third party are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise?

The key components of the question are:

1. Will the investor be making an investment of money with the intention to earn a profit?
2. Will there be a “common enterprise”, that is, an enterprise in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties?
3. Do the investors expect to make a profit
 - (a) based solely on the efforts of others, or
 - (b) based on the efforts of others where the efforts of those others are expected to be undeniably significant and will be the managerial efforts essential to the success or failure of the enterprise?

In considering the matter, the seller must look to the substance of the transaction, not the form. The fact that an enterprise is referred to as a “joint venture” or “partnership” does not prevent a conclusion that an investor is, in fact, dependent upon the efforts of the seller or a third party. Factors that suggest that the investor is dependent include the following:

- the investor has limited legal rights,
- the investor’s practical ability to exercise its legal rights is limited,
- the investor lacks the capability to intelligently exercise its powers,
- the investor’s role is intended to be passive,
- the investor is inexperienced or unknowledgeable in business affairs generally,
- the investor is reliant on the promoter’s efforts because of lack of business knowledge, finances or control over the operation,
- the promoter or manager has unique entrepreneurial or management abilities on which the investor is dependent, and
- the investor cannot, looking at practical realities, remove the manager.

This area of law was not certain prior to the Decision. Staff is prepared to allow issuers to get their affairs in order provided it is done promptly. Persons or companies that do not ensure they are in compliance with the Act risk having enforcement action taken against them, with possible added costs and sanctions.

A copy of the Decision can be obtained from the Commission’s website at www.albertasecurities.com under the heading “Enforcement” – “Enforcement Orders”.

MI 45-103 is also available on the Commission's website under the heading "Policies & Legislation" – "Instruments".

If you have any questions, please contact:

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