

A.S.C. POLICY 4.2
REQUIREMENTS FOR ESCROW OF SECURITIES
AND FOR RELEASES FROM AND TRANSFERS WITHIN
ESCROW IN RESPECT OF JUNIOR NATURAL
RESOURCE ISSUERS

1. INTRODUCTION

- 1.1 Promoters and other persons and companies (hereinafter referred to collectively for purposes of this policy as the "initial security holders") usually obtain equity positions in a junior natural resource issuer during its formative years through transferring or vending property to the issuer in exchange for securities of the issuer (the "vendor securities") and through purchasing securities of the issuer at prices lower than the offering price investors are asked to pay for securities acquired through the issuer's initial public offering.
- 1.2 One of the purposes of requiring the escrow of initial security holders' securities is to discourage the transfer of property of unknown value to an issuer for vendor securities where the intention of the initial security holders may be to dispose of the vendor securities, and other securities acquired at low prices, into the market at a profit without conducting any exploration and/or development work or conducting only a minimal amount of work, on the property to determine whether the property has value, and to then abandon their interest in the issuer to the detriment of the public investors. Accordingly, an escrow agreement assists in ensuring that the initial security holders
- 1.2.1 continue to have an interest in the affairs of the issuer and, having raised money from the public by sale of securities, do not abandon its public investors, and
- 1.2.2 retain an equity interest in the issuer and hence a continuing interest in its development and success while at the same time sharing, with the public investors from whom most of the equity capital has been raised, in the risk associated with the exploration and development activities of the issuer.
- 1.3 This policy should be read in light of the escrow agreement requirements referred to in sections 66(l), 96(2)(f) and 107(l)(m) of the Alberta Securities Act and section 120 of the Regulations made under the Act. Reference should also be made to Form 16 of the Regulations for form and content of an escrow agreement.

2. SECURITIES TO BE ESCROWED

- 2.1 It is not practical to provide a single formula which will result in the number of securities which the Director of the Alberta Securities Commission (the "Director") considers

appropriate to be escrowed. However, in determining the number of securities to be escrowed, the items set forth below will be considered.

2.2 One of the matters considered in determining the number of securities which may be subject to escrow is the extent of dilution which occurs in the offering price of the securities to the public at the time of the issuer's initial public offering as a result of

2.2.1 securities that have been issued to the initial security holders at less than the offering price to the public and

2.2.2 giving effect to securities issuable to the initial security holders

2.2.2.1 upon exercise of a right or option granted prior to the offering,
and

2.2.2.2 upon conversion of convertible securities

at a price below the offering price per security to the public.

2.3 In determining dilution, the net tangible assets of the issuer after giving effect to the net proceeds to its treasury (after deduction of commissions and other expenses of the offering)

2.3.1 raised from the proposed offering (exclusive of any proceeds that may be received upon the exercise at future dates of any rights or options included as part of the offering) and

2.3.2 which would be raised from the initial security holders if they exercised "all rights, options and conversions, if any, referred to in item 2.2.2

is divided by the number of securities issued after giving effect to

2.3.3 the proposed offering (exclusive of any securities that may be issued upon the exercise at future dates of any rights or options included as part of the offering) and

2.3.4 the exercise of all rights, options and conversions referred to in item 2.3.2

The difference between the quotient thus obtained and the offering price is the amount of dilution per security which the new investors incur. The percentage of dilution applied to the number of securities issued, after giving effect to the proposed offering and to the exercise of all rights, options and conversions referred to in item 2.3.2 produces the

number of securities which may be subject to escrow.

- 2.4 If the issuer is a junior oil and gas issuer, the net tangible assets referred to in item 2.3 may be adjusted by
 - 2.4.1 replacing the book value of properties and related deferred exploration and development costs with the present value of the estimated net cash flow from reserves discounted at 15% based on an independent engineer's evaluation of the proved and probable reserves relating to those properties calculated in accordance with National Policy 2-B. The evaluation may be based on escalated prices and escalated costs and if the evaluation has not discounted probable reserves for risk associated with obtaining production, then the evaluation of probable reserves will be reduced by 50% to allow for such risk, and
 - 2.4.2 replacing the book value of undeveloped acreage with an independent engineer's evaluation of the undeveloped acreage.
- 2.5 The number of vendor securities permitted to be issued for properties shall not exceed 750,000 except in those cases where the independent engineer's evaluation of the properties referred to in items 2.4.1 and 2.4.2 when divided by the proposed offering price to the public would give a result in excess of 750,000 in which case the larger number of securities may be permitted.
- 2.6 The dilution allowable on any offering shall not exceed 60%.
- 2.7 Notwithstanding any of the foregoing provisions of this policy, the Director may require more or fewer securities to be escrowed than indicated above depending upon the particular circumstances of a filing including but not limited to matters such as the extent of experience and successful track record of the promoter in the natural resource industry, the extent of previous exploration and development work performed on the issuer's properties, and whether the properties are known to contain any proven or probable reserves.
- 2.8 In respect of the number of securities which may be subject to escrow as determined above, the Director will normally consider acceptable the escrowing of only those securities beneficially owned, directly or indirectly, by
 - 2.8.1 promoters of the issuer,
 - 2.8.2 officers and directors of the issuer,
 - 2.8.3 all other insiders of the issuer, and
 - 2.8.4 associates of any of the above.

- 2.9 The escrow agreement shall comply with Form 16 of the Regulations.
- 2.10 The escrow agreement shall clearly disclose, in a schedule attached to and forming part of the agreement, and in respect of each security holder whose securities are escrowed, the number of escrowed securities which were issued for property and the number which were issued for cash or other consideration.
- 2.11 Unless acceptable reasons are provided to the Director, the promoter or any associate, affiliate or subsidiary of the promoter shall not retain any interest in any property transferred or vended to the issuer or in any property adjacent or contiguous to the property vended.
- 2.12 Notwithstanding item 2.9, in the case of a filing made in more than one jurisdiction and in respect of which a jurisdiction other than Alberta is the prime jurisdiction, the Director may determine that his acceptance of an escrow agreement and/or a pooling agreement as accepted by the prime jurisdiction would not be contrary to the public interest in Alberta.

3. RELEASE OF SECURITIES FROM ESCROW

- 3.1 The Director will consider a release of 15% of the escrowed securities upon satisfactory completion of the distribution of securities offered. An application for this initial release shall be accompanied by
 - 3.1.1 in the case of an underwritten offering, a certificate from the issuer, signed by two senior officers, confirming that the underwriter has paid the take-down amount of the offering to the issuer, or
 - 3.1.2 in the case of a best efforts offering, a letter from the trustee addressed to the Director confirming that the minimum subscription had been reached.
- 3.2 The Director will consider a release of 25% of the escrowed securities if the issuer satisfies the Director that it has completed the work program disclosed in the prospectus. A request for this release must be accompanied by a written confirmation by an independent engineer to the Director confirming that the work program has been completed.
- 3.3 In respect of the remaining 60% of the securities escrowed, 15% shall be automatically released by the trustee, on a pro rata basis, at the end of each of the second, third, fourth and fifth year from the date of the prospectus.
- 3.4 When the release under item 3.2 has been made, the Director shall provide his written consent to the trustee for the releases permitted under item 3.3.
- 3.5 An application to the Director for cancellation of escrowed securities pursuant to item 11 of the escrow agreement shall immediately stop the automatic release process under item 3.3 until the application is dealt with by the Director. The party making the application shall

advise all parties to the escrow agreement, including the trustee, of the application.

- 3.6 If the issuer or its initial security holders believe that an earlier release of a greater number of escrowed securities is appropriate than provided for in item 3.3, an application may be made to the Director for his written consent to an accelerated release. It is not practical to set forth a single formula which will give effect to all matters which will be considered by the Director in deciding upon an accelerated release. However, in determining the amount of an accelerated release, the matters set forth in items 3.7 to 3.13 will be considered.
- 3.7 If the value of the property, in respect of which vendor securities have been escrowed, has been enhanced as a result of the exploration and/or development work thereon as proposed in the issuer's prospectus, a consent for an accelerated release of securities from escrow may be granted. An application for release under this item shall be accompanied by
- 3.7.1 an independent engineer's current report on the property prepared in accordance with National Policy 2-A for mining properties and National Policy 2-13 for oil and gas properties
 - 3.7.1.1 describing the work program performed on the property,
 - 3.7.1.2 stating the proved and/or probable reserves, if any, or additional proved and/or probable reserves since the engineer's previous report on the property, discovered as a result of that program,
 - 3.7.1.3 containing the engineer's recommendations as to whether or not further exploration and/of development work on the property is warranted and, if so, the extent thereof, and
 - 3.7.1.4 containing the engineer's estimate of the cost of performing any such further work,
 - 3.7.2 the issuer's proposed plan for financing further exploration and development programs, and
 - 3.7.3 the issuer's most recent annual report to its security holders (including its audited financial statements) and its most recent interim financial statements.
- 3.8 If the issuer is a junior oil and gas issuer, the engineer's evaluation referred to in item 3.10.1 shall be calculated in accordance with the requirements of National Policy 2-B and, for purpose of calculating releases of securities from escrow, the evaluation may be based on escalated prices and escalated costs and shall be discounted at 15%. If the engineer's evaluation has not discounted probable reserves for risk associated with obtaining

production, then that evaluation will be reduced by 50% to allow for such risk.

- 3.9 In considering an application for an accelerated release of securities from escrow, the Director will be further inclined to grant a release if
- 3.9.1 the financial position of the issuer reflects satisfactory improvement since the securities were escrowed,
 - 3.9.2 the issuer is listed on a stock exchange and its securities trade thereon for a sustained period of time, in reasonable volumes, and at prices approximating or exceeding the offering price at which the issuer distributed its securities, or
 - 3.9.3 the issuer's properties are proven to contain commercial quantities of ore or oil and gas capable of profitable production.
- 3.10 The number of securities releasable in respect of vendor securities referred to under item 3.7 as well as other securities held in escrow will generally be based on the percentage increase in the value per security over the value per security calculated at the time the securities were escrowed. For this purpose the increased value per security will be calculated by dividing
- 3.10.1 the net tangible assets of the issuer (after substituting, if applicable, the independent engineer's evaluation of all the properties, including undeveloped acreage, in place of the book value of those properties (in the same manner as discussed in item 2.4) and after giving effect to the proceeds referred to in item 2.2.2)
- by
- 3.10.2 the number of issued and outstanding securities of the issuer, including securities which may be issuable as referred to in item 2.3.4.
- 3.11 If an application for an accelerated release of securities from escrow is received from a security holder, the application will be referred to the issuer for its comments.
- 3.12 If the securities are listed on a stock exchange, an application for an accelerated release will be referred to the stock exchange for its comments.
- 3.13 If an accelerated release of securities from escrow is granted, the securities will be released on a pro rata basis to all holders of the escrowed securities unless, in a rare case, circumstances appear to warrant a release on a different basis.
- 3.14 If a jurisdiction other than Alberta was the prime jurisdiction in reviewing a prospectus which resulted in the escrowing of securities and was also named as a party to the escrow agreement, the Director may exercise his discretion in favor of consenting to a request for release if

3.14.1 the prime jurisdiction confirms to the Director that it consents to the release,
and

3.14.2 in the opinion of the Director it would not be contrary to the public interest in
Alberta.

4. TRANSFERS WITHIN ESCROW

4.1 Transfers within escrow will be considered if the transfer

4.1.1 is shown to be of benefit to the security holders generally,

4.1.2 is necessary to settle an estate of a deceased security holder,

4.1.3 is for a number of securities less than 1% of the issued and outstanding securities
of the issuer and the transferor has not made any transfer of escrowed securities
within the preceding 12 months, or

4.1.4 is warranted by other circumstances.

4.2 The applicant requesting transfer must furnish the Director with full details of the
proposed transfer. If the transfer falls within item 4.1.1, the applicant must also submit
evidence giving reasons for the transfer. Consents of all or the majority of the security
holders to the proposed transfer may be required of the applicant in appropriate
circumstances.

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