

IN THE MATTER OF  
THE SECURITIES LEGISLATION  
OF ONTARIO, BRITISH COLUMBIA, ALBERTA,  
MANITOBA AND QUEBEC

AND

IN THE MATTER OF  
THE MUTUAL RELIANCE REVIEW SYSTEM  
FOR EXEMPTIVE RELIEF APPLICATIONS

AND

IN THE MATTER  
OF STERLING FINANCIAL CORPORATION

AND

PREFERRED EQUITY LIMITED  
PARTNERSHIP UNITHOLDERS

MRRS DECISION DOCUMENT

WHEREAS the local securities regulatory authority or regulator (the "Decision Maker") in each of Ontario, British Columbia, Alberta, Manitoba and Quebec (the "Jurisdictions") has received an application from Sterling Financial Corporation ("Sterling") for a decision pursuant to the securities legislation of the Jurisdictions (the "Legislation") that the requirements contained in the Legislation to be registered to trade in a security and to file and obtain a receipt for a preliminary prospectus and a prospectus (the "Registration and Prospectus Requirements") shall not apply to the distribution by Sterling of common share purchase warrants, Series I and Series II (the "Warrants") exercisable for common shares of Sterling ("Sterling Common Shares") and the distribution of promissory notes (the "Notes") of Senior Preferred Hotels Limited Partnership ("Senior Partnership") to Preferred Equity Limited Partnership H Unitholders ("H Unitholders");

AND WHEREAS pursuant to the Mutual Reliance Review System for Exemptive Relief Applications (the "System"), the Ontario Securities Commission is the principal regulator for this application;

AND WHEREAS Sterling has represented to the Decision Makers as follows:

1. Sterling is a hotel investment company and real estate lender whose activities are primarily conducted in the United States. Sterling's corporate headquarters are located at 6900 East 2<sup>nd</sup> Street, Scottsdale, Arizona, 85251. Sterling's registered office is located at Suite 703, 123 Edwards Street, Toronto, Ontario, M5G 1E2.

2. Sterling was originally incorporated under the name Goldvue Mines Limited under the laws of Ontario by Letters Patent dated September 7, 1944 and during the next few decades changed its name several times. On February 8, 1988, the company changed its name to Samoth Capital Corporation. On May 29, 2000, the company changed its name to Sterling Financial Corporation.

3. In 1996, Sterling, then called Samoth Capital Corporation, invested in under-valued, mid-market hotel properties in growth-oriented markets and secured an interest in the cash flows of such properties. Sterling acquired eight hotels in June, 1996 and fifteen hotels in March 1997. These acquisitions increased Sterling's portfolio to 28 hotels in Florida, Kansas, Missouri, New Mexico and Texas. Sterling also acted as a mezzanine lender in the multi-family residential and master planned community sectors of the real estate industry in Arizona, California, Florida, Nevada, Texas and British Columbia.

4. In late 1997 and 1998, the U.S. limited service hotel industry deteriorated and, along with it, the value of Sterling's portfolio. Sterling subsequently reduced its portfolio to ten hotels. Today, Sterling continues its focus on real estate lending, the development and re-development of commercial and retail real estate, investing in master-planned communities and multi-family projects.

5. Sterling is a reporting issuer in the provinces of Ontario, British Columbia, Saskatchewan, Manitoba, New Brunswick, Prince Edward Island, Nova Scotia, Newfoundland and Quebec, as a result of filing a final prospectus and obtaining a receipt for same in June, 1994. 6. Sterling is not on the list of defaulting reporting issuers pursuant to the Legislation maintained by the Jurisdictions.

7. Sterling Common Shares are listed for trading on The Toronto Stock Exchange (the "TSE") under the symbol SCF.

8. As of April 2, 2001, there were 36,534,784 Sterling Common Shares issued and outstanding on the TSE.

9. Preferred Equities Limited Partnership ("PELP") was formed pursuant to the laws of the province of British Columbia by the filing of a Declaration of Partnership in the Office of the Registrar of Companies on June 3, 1996, with Preferred Equities Ltd. ("Preferred Equities") registered as the General Partner. PELP's head office is 6900 East 2<sup>nd</sup> Street, Scottsdale, Arizona, 85251, and its registered address is Suite 2900, 595 Burrard Street, Vancouver, British Columbia, V7Y 1B6.

10. Preferred Equities is a non-reporting company incorporated under the laws of British Columbia on March 21, 1996, whose issued and outstanding shares are owned by Samoth Equity Corporation, a wholly-owned subsidiary of Sterling.

11. PELP was formed to invest in two specific projects: the indirect acquisition of an interest in eight hotels and one office building and an interest in the Ventana Project (defined herein).

12. Each of the eight hotels and office building are owned by a separate limited partnership (the "Limited Partnerships"). Master Preferred Hotels Limited Partnership (the "Master Partnership"), whose general partner is Master Preferred Hotels, Inc. ("Master Preferred Hotels"), an indirect, wholly-owned subsidiary of Sterling, is the limited partner of each of the Limited Partnerships. The limited partnership units of the Master Partnership are owned by Senior Partnership, whose general partner is Senior Preferred Hotels, Inc. ("Senior Preferred Hotels"), an indirect, wholly-owned subsidiary of Sterling. The limited partnership units in the Senior Partnership are owned by PELP and Preferred Equity (U.S.) Limited Partnership (the "U.S. Partnership"), a limited partnership for U.S. investors whose general partner is Preferred Equity US, Inc., an indirect, wholly-owned subsidiary of Sterling. Since the acquisition of the hotel portfolio in 1996, three hotels and the office buildings have been sold.

13. Senior Partnership is a limited partnership formed under the laws of Delaware and it is not a reporting issuer in Canada or in the United States.

14. Pursuant to a July 29, 1996 private placement (the "Private Placement"), PELP offered units in PELP (the "Offering"), raising gross proceeds of US\$7,200,000, to finance (i) the purchase of units in the Senior Partnership which indirectly owns the Limited Partnerships and (ii) the loan to assist in the funding of the construction of an apartment development in Las Vegas, Nevada (the "Ventana Project").

15. The Offering consisted of hotel units (the "H Units"), which relate to the investment in the hotels and office building Limited Partnerships and the Ventana Project units (the "V Units"). A subscriber whose subscription was accepted became a limited partner in PELP.

16. The H Units or V Units entitle the unitholder to either hotel distributable cash ("Hotel Distributable Cash") or the Ventana Project distributable cash ("Ventana Project Distributable Cash"). The Hotel Distributable Cash means all revenue related to PELP's interest in the Senior Partnership earned by PELP after deducting all expenses related to PELP. The Ventana Distributable Cash of PELP is defined as all revenue related to PELP's interest in the Ventana Loan earned by PELP after deducting all expenses related to PELP's interest in the Ventana Loan. The Ventana Project was completed in 1999 and all Ventana Project Distributable Cash has been paid to V Unitholders. No further distributions are owing to the V Unitholders.

17. The Offering offered investors investment benefits in both projects and the combination in a single Offering provided investors with the opportunity to obtain a blend of early return of capital, profit distribution, continuing cash flow and equity growth.

18. The Private Placement was made pursuant to exemptions from the prospectus requirements afforded by subsection 74(2)(4) of the *Securities Act* (British Columbia), subsection 128(b) of the Rules to the *Securities Act* (British Columbia), subsection 72(1)(d) of the *Securities Act* (Ontario), subsection 107(1)(d) of the *Securities Act* (Alberta), section 58 of the *Securities Act* (Manitoba) and section 43 of the *Securities Act* (Quebec).

19. Within 90 days of each fiscal year of PELP, PELP provides each H Unitholder with unaudited annual financial statements of PELP.

20. In each of the calendar years 1999, 2000, 2001, 2002 and 2003, on a date to be determined by Preferred Equities, in consultation with Sterling, H Unitholders were to have the option to exchange (the "Exchange Feature") up to 25% of the H Units outstanding as at December 31, 1998 into Sterling Common Shares (then common shares of Samoth Capital Corporation), based upon the then current market value of PELP's interest in the Senior Partnership.

21. On October 25, 1999, Sterling (then known as Samoth Capital Corporation) obtained exemptive relief from the Decision Maker in each of the Jurisdictions that the Registration and Prospectus Requirements do not apply to the exchange of Sterling Common Shares for H Units.

22. PELP then provided notice of the Exchange Feature to all H Unitholders on November 4, 1999. However, none of the H Unitholders chose to exercise their option under the Exchange Feature and no H Units have been converted. The present value of PELP's interest in the Senior Partnership makes the Exchange Feature of little value such that an H Unitholder would receive few, if any, Sterling Shares upon its exercise.

23. The H Unitholders subsequently became disappointed with the performance of their investment and made certain claims and allegations related to management of PELP and the sale by PELP of its limited partnership units. Accordingly, the H Unitholders formed a committee (the "Committee") to conduct negotiations and retained legal counsel to act on its behalf.

24. Sterling, the Senior Partnership, the U.S. Partnership and the Committee have reached an agreement in principle relating to a settlement agreement and release (the "Settlement Agreement"), whereby:

(a) each of the H Unitholders agrees to convey to the U.S. Partnership all of their right, title and interest in the H Units owned by such H Unitholders;

(b) the Senior Partnership agrees to deliver a promissory note (the "Note") to each of the H Unitholders in an aggregate amount of US\$5,400,000;

(c) the Notes have the following material attributes:

(i) the Notes are for a term of 5 years and interest at 5% per annum is to be paid annually;

(ii) if a real estate asset owned by one of the limited partnerships is sold, the net sale proceeds received in excess of any tax liability with respect to same is to be applied to the outstanding principal, subject to the prior payment of three outstanding loan facilities;

(iii) the Notes are secured by a Pledge and Security Agreement which grants a security interest in certain limited partnership units owned by Senior Partnership in Master Partnership and by a guarantee executed by Sterling limited to the amount of any new liens which may rank prior to the Pledge and Security Agreement;

(d) the Senior Partnership agrees to grant to each of the H Unitholders a security interest in all of the issued and outstanding limited partnership interests in Master Preferred Hotels, L.P.;

(e) the Senior Partnership agrees to pay to each of the H Unitholders, such H Unitholder's pro rata share of a US\$49,000 fund, as a reimbursement of any costs incurred by such H Unitholder in respect of the Settlement Agreement;

(f) Sterling agrees to issue to H Unitholders, in aggregate, 900,000 common share purchase warrants, Series I and Series II (the "Warrants"), to purchase a total of 720,000 Sterling Common Shares at an exercise price of Cdn\$1.50 per share for the Series I warrants and a total of 180,000 Sterling Common Shares at an exercise price of Cdn\$2.00 per share for the Series II warrants, each series to be exercisable for a period of five years;

(g) the Warrants will be issued pursuant to a Share Purchase Warrant Indenture between Sterling and a Canadian trust company;

(h) the H Unitholders agrees to release Sterling and the various limited partnerships from any and all claims.

25. The Settlement Agreement is presently being considered by the H Unitholders and will not become effective until all H Unitholders have agreed to the terms of the Settlement Agreement.

26. As at April 2, 2001, 57 Canadian H Unitholders held a total of 598 H Units. Pursuant to the Settlement Agreement, it is proposed that Notes and Warrants will be distributed as follows:

(a) Ontario - 8 H Unitholders will receive in aggregate US\$1,560,000 principal amount of Notes, 208,000 Warrants, Series I and 52,000 Warrants, Series II (of which 3 H Unitholders will receive a Note with a principal amount of less than US\$98,175, which is equivalent to Cdn\$150,000);

(b) British Columbia - 46 H Unitholders will receive in aggregate US\$2,782,500 principal amount of Notes, 371,000 Warrants, Series I and 92,750 Warrants, Series II (of which 32 H Unitholders will receive a Note with a principal amount of less than US\$63,486.50, which is equivalent to Cdn\$97,000);

(c) Alberta - 1 H Unitholder will receive in aggregate US\$52,500 (Cdn\$80,220) principal amount of Notes, 7,000 Warrants, Series I and 1,750 Warrants, Series II;

(d) Quebec - 1 H Unitholder will receive in aggregate US\$37,500 (Cdn\$57,300) principal amount of Notes, 5,000 Warrants, Series I and 1,250 Warrants, Series II;

(e) Manitoba - 1 H Unitholder will receive in aggregate US\$52,500 (Cdn\$80,220) principal amount of Notes, 7,000 Warrants, Series I and 1,750 Warrants, Series II.

26. All of the H Unitholders have a significant net worth, are sophisticated investors and have access to professional and financial advice.

27. Pursuant to the Settlement Agreement, 11 U.S. residents who are H Unitholders in the U.S. Partnership will receive in aggregate US\$915,000 principal amount of Notes, and 122,000 Warrants, Series I and 30,500 Warrants, Series II.

28. The aggregate amount of US\$5,400,000 of Notes to be issued to the Canadian and U.S. H Unitholders to be exchanged for their H Units is less than the approximately US\$7,200,000 originally paid by those H Unitholders for their Units, partly as a result of payments made to the H Unitholders by way of return of capital upon the sale of certain properties and partly as a result of negotiations between the parties. The amount of the Note received by each H Unitholder may be taken to approximate the value of the H Units exchanged by such H Unitholder for the Note.

29. Sterling has applied to the TSE for listing approval of the additional Sterling Common Shares to satisfy the exercise of the Warrants.

30. The Sterling Common Shares issuable upon the exercise of the Warrants have not been registered under the United States *Securities Act* of 1933 or the securities laws of any U.S. state.

31. Sterling and the H Unitholders wish to conclude the Settlement Agreement they have reached and although the H Units were originally distributed pursuant to available exemptions, the aggregate acquisition cost of the Notes and the Warrants to each of the H Unitholders prevents Sterling and the H Unitholders from relying on statutory exemptions from the Registration and Prospectus Requirements contained in the Legislation.

AND WHEREAS pursuant to the System this Mutual Reliance Review System Decision Document evidences the decision of each Decision Maker (collectively, the "Decision");

AND WHEREAS each of the Decision Makers is satisfied that the test contained in the Legislation that provides the Decision Maker with the jurisdiction to make the Decision has been met;

THE DECISION of the Decision Makers pursuant to the Legislation is that the Registration and Prospectus Requirements shall not apply to:

A. the issuance of the Notes by the Senior Partnership to H Unitholders in accordance with paragraph 24 above, provided, however, that the first trade or resale of such Notes will be a deemed distribution or a primary distribution to the public under the Legislation of each Jurisdiction; and

B. the issuance of the Warrants by Sterling to the H Unitholders in accordance with paragraph 24 above, provided, however, that the first trade or resale of the Sterling Common Shares acquired upon the exercise of such Warrants will be a deemed distribution or primary distribution to the public under the Legislation of

the Jurisdiction in which such distribution or resale takes place (the "Applicable Legislation") unless at the time of such resale or first trade:

- (i) Sterling is a reporting issuer and is not in default of any of the requirements under the Applicable Legislation;
- (ii) if the seller is in a special relationship with Sterling (where such expression is defined in the Applicable Legislation) the seller has reasonable grounds to believe that Sterling is not in default of any requirement of the Applicable Legislation;
- (iii) no unusual effort is made to prepare the market or to create a demand for the Sterling Common Shares, and no extraordinary commission or consideration is paid in respect of such first trade; and

(iv) disclosure of the exempt trade is made to the Decision Maker(s) in accordance with the provisions (if any) of the Applicable Legislation, then, in all Jurisdictions other than Quebec, such first trade is a distribution or a primary distribution to the public only if it is a trade made from the holdings of any person, company or combination of persons or companies holding a sufficient number of any securities of Sterling to affect materially the control of Sterling (any holding of any person, company or combination of persons or companies holding more than 20% of the outstanding voting securities of Sterling shall, in the absence of evidence to the contrary, be deemed to affect materially the control of Sterling).

Dated this 25<sup>th</sup> day of April, 2001

"Derek Brown"  
Derek Brown

"Howard I. Wetston"  
Howard I. Wetston

#### Headnote

Mutual Reliance Review System for Exemptive Relief Applications – trades made in connection with restructuring of existing investment in a related group of companies exempt from prospectus and registration requirements – investors have significant net worth, are sophisticated and have access to professional and financial advice – first trade in common shares acquired on exercise of warrants deemed a distribution – resale subject to conditions analogous with restrictions that would have been imposed by applicable legislation.

#### Applicable Ontario Statutes

Securities Act, R.S.O. 1990, c.S.5, as am., ss. 25, 35(1)(5), 53, 72(1)(d) and 72(5)

#### Applicable Ontario Rules

Rule 45-501 Exempt Distributions

Rule 72-501 Prospectus Exemption for First Trade Over a Market Outside Ontario