Law 461c Corporate Transactions
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By

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Note: The materials here may not be in the same order as in the syllabus, but are arranged in the way that makes sense to me. I'm sure that you can work this out.

461C Corporate Transactions

Disclosure obligations are a contextual, and require the exercise of judgment.

BCE Inc. v. 1976 Debentureholders [2008] SCC

Under a Statutory Plan of Arrangements, the court has to consider the interest of all parties involved.

American Cases 33

Unocal Co. v. Mesa Petroleum Co. [1985] DEL SC

If the Board is disinterested and act in good faith, its decision in the absence of abuse of discretion will be upheld by the business judgment rule.

Revlon Inc v. MacAndrews & Forbes Holding [1986] DEL SC

Where the breakup of the company is inevitable, the duty of the directors changes to getting the highest price, and in such situations, White Knight favoritism to the total exclusion of a hostile bidder, is inappropriate, especially where the bidders make similar offers. This could be the law in Canada

Shareholder Rights Plans 35

In the Matter of Canadian Jorex ltd. [1992] ON SecCom

If the SRP is against public interest as declared by NI 62-202 it will be struck down

Re Royal Host Estate Investment Trust [1999] BC SecCom

Every ruling on SRPs will be based on the facts of each case, to decide if it is contrary to public interest

In the Matter of Inco Ltd. and Teck Cominco Ltd. [2006] ON Sec Com

Where it is in public interest to do so, the Sec Com will lift an SRR

In the Matter of Falconbridge Ltd. [2006] ON SecCom

SRP will be maintained where it protects SHs from a potential risk of being fucked over.

Neo Material Technologies inc. and Pala Investments [2009] ON SecCom

SRPs may be adopted to safeguard the long-term interest of SH, consistent with reasonable business judgements.

Restricted Voting Shares 38

TSX Policy Manual

624 Restricted Securities

OSC Rule 56-501

1.2 Application

2.2 Dealer Advisor Documentation

2.3 Minimum Disclosure in Offering Documents and Information Circulars

3.2 Prospectus Exemption Not Available

4.1 Determination of Status

Saunders v. Cathton Holdings ltd [1997] BC CA

Coattails can be a bitch

Insider Trading 41

Securities Act BC

57.2 Insider trading, tipping and recommending

57.3 Front running

57.4 Defences

57.5 Obstruction of justice

87 Insider reports

Superintendent of Brokers v. Pezim, Page, and Ivany [1994] SCC

The duty on senior officers to disclose material change within ten days includes a duty for senior management to keep informed of material info that exists so it can be disclosed as soon as practicable.

R. v. R.Bennett, H.Doman, and W.Bennett [1989] BC PC

The criminal burden of proof is applicable in persecuting insider trading, and is very hard to meet.

R. v. Felderhof [2007] ON PC

Insider trading is a pretty hard offence to nail someone with

Special Transactions 45

Capital Markets

Capital: Money or any right to receive money. There is no limit on form of the right to receive money. These can range from simple promises to pay a stated amount on a given date (promissory notes which are the safest of securities) to indications that an undetermined portion of an undetermined amount, existing at an undetermined date, may be paid (common shares, which are the riskiest of securities).
Securities: In the broad definition these are documents (contracts) offered in exchange for cash or other benefits which grant the purchaser a claim on future cash flows or other economic services. These can be stocks, bonds, debentures, options, futures, derivatives, or a whole shitload of other arrangements. The narrow definition includes only types of instruments presently traded, mainly bonds and stocks, the dealers trading them, and the financial markets in which they are traded.
Liquidity: The ability to convert securities into cash quickly at minimum cost and without a significant decrease in price caused by transaction.
Liquid Securities: Securities that can be easily sold at the FMV.

Capital Markets: Forums where different forms of capital change possession.
Primary Capital Markets: Trade in securities sold by their original issuer to obtain access to the necessary number of buyers at the same time.
Secondary Capital Markets: Trade in securities that are not currently in the possession of their creator. Holders of securities may obtain money for their securities immediately by selling them to third parties, rather than waiting until original issuer make payments pursuant to the right to receive money evidenced by them.
Upstairs Market: A network of trading desks for the major brokerage firms and institutional investors, which communicate with each other by means of electronic display systems and telephones to facilitate block trades and program trades, as opposed to trading on the stock exchange.

Issue: A sale of security by the original creator (issuer). This is sold through an underwriter to investors, either privately or by and IPO.
Liquidation: A sale of security by its holder who is not the issuer.
Control Premium: An amount that a buyer is willing to pay over the FMV of a SH. This premium is justified by the expected synergies, such as the expected increase in cash flow resulting from cost savings and revenue enhancements achievable in the merger. Normally, the control premium is industry-specific and amounts to 20–30% of the market capitalization of a CO calculated based on a 20 trading days average of its stock price.

- Every security sold by an issuer and remains outstanding is available to buyers in the secondary capital market.
- Secondary market establishes the FMV of securities, so that issuer can figure out the amount of new securities they must sell to raise the money they require. Hence the interaction between the primary and secondary markets.
    - Holders of securities estimate their monetary value
    - Holders of money ascertain the merit of exchanging their money for securities.

For the purpose of describing capital markets, the economy is divided into two sectors:
- Real sector
    - This is comprised of persons, non-financial business and governments.
    - The decisions are made by economic units to save, consume, or spend less than current income, while other units decide to spend more than they earn using the saving of former group to finance their deficiency. This creates transactions of flow of money between those who have a surplus due to savings, and those who have a deficit due to spending.
- Financial Markets
    - Accommodate the transfer of funds from surplus units to deficit units within the real sector
    - This can be done directly by offering securities issued by the deficit units to the surplus units
    - Or it can be done indirectly by financial institutions acquiring the claims of deficit units and then issuing new claims, which are tailored more closely to the requirements of surplus units.
    - Financial institutions attract savings by issuing claims on themselves which are more liquid, less risky or of shorter term, process of intermediation.

Primary and secondary capital markets serve following key purposes
1. Allow original issuers who have an immediate use for money to buy money by selling their securities

2. Permit original issuers to determine how much money they will receive for various kind of securities
3. Permit holders of money who have no immediate use to invest in securities
4. Permit holders of securities to liquidate their holdings for money

Fundamental basis of securities regulation is the protection of the public interest and maintaining efficient capital markets.

Efficiency of capital markets is the ability to fulfill its four primary purposes. It achieves these through:

- The channeling of savings
  - Markets channel funds from surplus units to deficit units.
- Reward for saving
  - Capital markets establish the rate of exchange between present dollar and future dollar.
  - Savings is the decision to postpone consumption
  - Future dollars are greater than present dollars by the return earned through savings
- Cost of Financing
  - Second purpose of financing market is to establish the cost of financing for the borrower and the rate of return on these financing vehicles for the lender.
  - Investment decisions are made based on the cost of funds on the basis of comparing the expected returns and perceived riskiness of the project on which he intends to invest in
  - The opportunity cost of financing is called cost of capital
  - Decision rule is to accept a capital investment proposal if its anticipated rate of return is greater than, or at the margin just equal to, the firm's cost of capital.
- Liquidity
  - Capital markets facilitate liquidity, transforming short-term funds to long-term use
  - Transformation allows much larger flow of savings to be made available for long-term investment, financial institutions do this through intermediation
- Providing a market that is equivalent with other secondary capital markets around the world
  - The more capital is available in a market, the more efficient the market is.
  - Thus a market is interested in keeping people trading at it.
  - Any market that is less efficient or more restrictive, will scare away investors, who will go and trade elsewhere.
- Value basis
  - Last purpose of financial market is to establish a basis for valuation

Dominant markets in Canada

- Money Market:
  - Handles short-term debt securities, usually of one year or less to maturity, issued by governments and both non-financial and financial COs.
  - Everything on this market is very liquid and investment-rate graded and safe.
  - It is a dealer market, where underwriting investment dealer or financial institution buys the offering from the issuing unit and then sells the securities in parts to financial institutions, COs and other institutions such as universities, or hold some of the issue itself.
  - This is mainly a primary market, trading of these instruments in secondary markets.
- Bond Market:
  - As opposed to the money market, the bond market deals with long-term debt securities, typically of 5 years or more.
  - The interest derived from bonds (called coupon) will depend on the risk rating on the security.
  - Has both primary and secondary operations. Investment dealers act as underwriters and buy the primary issue and distribute to financial institutions and the public.
  - The secondary market involves dealers buying bonds for and selling bonds from their own inventory.
  - This market also involves a large amount of hedge fund investors.
- Equity/stock market:
  - Dealers underwriting corporate issues and distributing them to financial institutions and individual investors.
  - Secondary equity markets are mainly auction markets where bids and offers are made by broker for their clients on listed stocks on a stock exchange
  - Markets for some stocks not listed on exchange are maintained by dealer buying for and selling from their inventory
  - Secondary Offerings: an underwriter acquires a block of stock from a stockholder and distributes it in much the same way as a primary issue in order to avoid putting stress on the secondary market by selling such a large transaction

Intermediaries in the Capital Market

Stock brokers and investment dealers

- Brokers and dealers are the primary intermediaries in the trading of securities.
- These are professionals in locating buyers and sellers of securities and mostly operate on an agency basis.
- Sometimes they also act as underwriters and purchase securities as principals into their inventories, which permit seller of a large number of securities to sell them all at once with a goal to immediately re-selling.
- The rest of the intermediaries are there to keep the brokers and dealers from fucking around.

Accountants

- Brokers and dealers lie all the time, so CAs are there to make sure that their financial statements are audited, to make sure that they reflect the underlying financial reality of the issuer.
- CAs form the basis of most decisions to buy or sell an issuer's securities, providing independent expert opinion on the accuracy and method of preparation of these financial statements
- CAs generally follow accounting standards in *CICA Handbook*
- Should usually follow GAAP, and the onus is on practitioners to justify departure from the consensus of the most widely circulated ways of accounting
- There is also the GAAS which is the generally accepted auditing standard.
- OSC supports self regulation instead of prosecuting delinquent accountants and auditors on criminal charges under s. 118 of the *Securities Act*
- Enforcement matters fall within jurisdiction of the provincial institutes
- Users do not fully understand the limitations of present-day financial reports. Nor do they fully appreciate the concepts of materiality and judgment applied in auditing them. Management is in the best position to explain and interpret their CO's results and the nature of the financial reporting process
- Even if financial statements contain relevant and reliable data, their utility depends on whether users believe the data. This in return, depends on the users' faith in the system of financial reporting and the competence and integrity of the auditor of a particular set of financial statements.

Generally Accepted Accounting Principles (GAAP):

- The law used to be that an auditor had to give an opinion as to whether the financial statement were made up in accordance with GAAP
- NP-27 has been sometimes interpreted to mandate the use of GAAP, but it does not so state this expressly.
- GGAP was mandated for *CBCA* COs by regulations enacted under that *Act*
- Part XVII, s.76(1) and s.77(1) of *CBCA* mandate the use of GAAP for interim and annual financial statements and s.2(1) of the Regulations mandates GAAP for all other financial statements
- This is a little problematic because GAAP is like common law: CICA can only make recommendations, and has no power to enforce, and GAAP changes all the time.
- Having legislated GAAP it is necessary to give OSC power when broader social issues are involved (s.79 of the *Act*). For example, an issuer may seek exemption from the segmented reporting requirements of GAAP on the ground that it would be unduly prejudicial

Securities Lawyers

The role of lawyers in the financial markets is threefold:

1. Insure that the intent of buyers & sellers of securities is reflected in the documents that evidence the transaction;
2. Monitor compliance with the applicable laws by buyers & sellers
3. Have a responsibility to insure that a transaction does not violate the public interest in efficient capital markets.

US approach to a securities lawyer's role

- In US, the profession is governed by the *Code of Professional Responsibility*. According to it, a lawyer employed or retained by a CO or similar entity owes his allegiance to the entity and not to a stockholder, director, officer, employee, representative, or other person connected with the entity.
- But SEC said that professionals involved in disclosure are real representatives of the investing public served by the SEC
- This was affirmed in the case of *Security v. Spectrum Ltd* [1973].

- The new SEC position is that a securities lawyer has a duty to the public and that in certain cases, this duty takes priority over this duty to his client

- *National Student Marketing* [1976] USCA:
  - SEC's position was that attorneys had an obligation to the SEC and the public which transcends the attorney's obligation to their respective clients
  - SEC further stated that if the client refused to follow the advice of lawyers to disclose, lawyers should have resigned and informed the SHs or the SEC. This "blow the whistle" approach caused considerable stir among securities lawyer in the US. No shit: this is blatant violation of the lawyer-client confidentiality.
- *Carter-Johnson* [1981] SEC:
  - CEO was the controlling SH of the CO and repeatedly refused to follow the securities lawyer's advice. He also failed to keep the securities lawyers informed about material developments.
  - Trial judge suspended the lawyer from practicing before the SEC for a period of time, but the decision was reversed on appeal to the SEC
  - ABA recommended some options for lawyers who are confronted with such a situation:
    1. Discuss failure to disclose with one of the CO's outside directors. In general, when the CEO is the majority SH, the lawyer should have a pretty close relationship with the outside directors, just in case if shit goes down.
    2. Raise the fact of non-disclosure with the Board as a whole
    3. Resign from the account

Aiding and Abetting a Violation of Disclosure under SEC:

Three elements are necessary in the aiding and abetting of a violation of disclosure

1. There exists an independent securities law violation committed by some other party
2. The aider and abettor knowingly and substantially assisted the conduct that constitutes the violation
3. The aider and abettor was aware or knew that his role was part of an activity that was improper or illegal

- The emphasis on the third element, critical element. Need to show "wrongful intent." This is because a lawyer must have the freedom to make innocent (or even in certain cases, careless mistakes) without fear of legal liability or loss of the ability to practice before the SEC.
- SEC stated that securities lawyer should make an effort to correct disclosure problem in lieu of resignation by directly approaching the Board, to one or more directors, or to other senior officers

Ontario approach to a securities lawyer's role

- A securities lawyer advises his client of what is reasonable for disclosure and assists client in carrying out a due diligence investigation.
- The ON *Securities Act* includes civil liability remedies for misrepresentations contained in prospectuses, takeover bid circulars, and directors' circulars.
- Misrepresentation in information circulars, press releases and annual reports do not carry civil liability in ON.
- If client is found liable for misrepresentation in a disclosure document, the client could sue the lawyer for negligence
  - The defence would be that the lawyer had acted in accordance with the standards of a reasonably prudent securities lawyer in the community in which he practices.

- The goal of securities laws is the protection of the public investor via full disclosure and it will not be hindered by allowing the legal profession to define the standards of due diligence.
- The differences in size, nature of practice, organization, location and quality of lawyers and clients among firms makes it impossible to set out guidelines and standards in an inflexible form.
- Securities lawyer's advice is conclusive as to when, whether and how disclosure is made, but is not enough to make the lawyer accountable or liable to SHs or the investing public by reason only of the public CO's failure to comply with a disclosure obligation.
- Securities lawyers must take into account the interest of SHs and investing public as well as the Board on disclosure questions.
  - If these interests were not taken into account, lawyer is accountable to the CO. If the CO misrepresented in disclosure documents on the negligent advice of its lawyer, CP can sue him.
- Proper roles of securities lawyers and commission in the regulation of the capital market can be seen in the trilogy of *Torstar and Southam*, *Canadian Tire*, and *Nova Scotia Savings and Loan*,

In the Matter of Torstar and Southam [1986] ON SC

Where client wants to proceed with an illegal transaction despite the lawyer's advice, the lawyer should refuse to act for that client.

Facts: Directors of Southam and Torstar conducted a number of transactions which involved a willful breach of TSX By-law 19.06, notwithstanding advice from counsel that it may result in persona penal sanctions against Boards. By-law requires every CO listed on TSX to give prompt notice of a proposal to issue treasury securities and to supply a copy of each agreement entered into with respect to such issue. It further provides that the TSX shall have the right to either accept or not accept such notice, or to require shareholder approval as a condition of acceptance in certain circumstances. So the effect of the impugned transaction was to deny Southam's SHs a possibility of receiving TOB at price in excess of current market price.

Issue: What should the lawyers have done?

Discussion:

- Role of the lawyers:
  - Here, the lawyer aware of the illegality of the transaction had three options: try some other transaction, insist on TSX approval, or refuse to act.
- There is a need to weigh (in a negligence kind of equation) the harm created against the harm avoided by their actions.
- Here, lawyers should have refused to participate in this transaction.

Ruling: Commission removed BOD s.124 exemptions for 6 months, one of the harshest penalties it has ever imposed.

Corporate Capital Structure

General

- COs require funds for a variety of purposes: for working capital, payrolls, and long term purposes such as acquiring land, equipment, etc.
- Financing of working capital is usually done on short term basis.
- Funds required for long term purposes are usually not available from accumulated retained earnings and have to be usually provided through permanent capital or long term borrowings.

Introduction to Capital Structure

- The form of organization of capital structure is a method of allocating and balancing three elements of the enterprise:
  - Risk of loss
  - Power of control
  - Participation in profits of the business while it is a going concern, and in the assets on break up of the CO
- A CO allocates these elements through the "capital structure", distributing elements of risk, control, and participation through fixing terms of securities and their amounts.
- Thus, when examining existing capital structure of a CO, the important questions to ask are:
  - Who bears the risk of loss?
  - Who votes, and in what circumstances, and whose votes control?
  - Who has the first claim on earnings, who has the first claim on assets, and who has the residual claim on earnings and assets when all prior claims are paid?

Capital: Different fields have different definitions for capital in different contexts. Lawyers often use it to mean shareholder equity on the liability half of the balance sheet, distinguishing it from claims of creditors and banks, which are listed as standard liabilities. Thus in the common narrowest use of the word, capital is share capital.

Financial Statements

There are three most fundamental financial statements in corporate finance. Examples of each are given in the course package on 2-4:

- Balance Sheet
- Income statement (or earnings statement or statement of profit and loss)
- Retained earnings statement (earned surplus statement)

The creation of corporate structure is the balancing between the assets on one side, and the liabilities and shareholder equity on the other. The balance between the liabilities (which include bonds and debt) and shareholder equity is determined through capitalization of the CO.

Balance Sheet: A summary of the financial balances of a CO. Assets, liabilities and ownership equity are listed at a specific point in time, such as the end of its financial year. A balance sheet is often described as a snapshot of a company's financial condition.
Income Statement (P&L Statement): A CO's financial statement that indicates how the revenue is transformed into the net income (the result after all revenues and expenses have been accounted for, also known as the "bottom line") over a period of time. It displays the revenues recognized for a specific period, and the cost and expenses charged against these revenues, including write-offs (depreciation and amortization of assets) and taxes. The purpose of the income statement is to show managers and investors whether the CO made or lost money during the period being reported.
Retained Earnings Statement: Explains the changes in a CO's retained earnings over the reporting period. It breaks down changes affecting the account, such as profits or losses from operations, dividends paid, and any other items charged or credited to retained earnings.

EBITDA: Earnings before interest, taxation, depreciation, and amortization. It purports to measure cash earnings without accrual accounting, canceling tax-jurisdiction effects, and canceling the effects of different capital structures. This is a number that is more interesting to take-over bidders than the balance sheet or the income statement, since many of the factors excluded from EBITDA are context specific (such as interest or taxes) or artificial (such as depreciation).

Capital Structure

Debt Securities: Create a debtor-creditor relationship between the securities holder and the CO. These are comprised of bonds, debentures, and notes
Equity Securities: Shares of a CO that create a shareholder relationship.
Shares: A measure of interest of the holder, but not part ownership in assets or CO undertaking. This is the only form of security issued by a CO which represent an investment that doesn't result in a debtor-creditor relationship. It does not mean part ownership of CO's assets. Ownership of a share gives a SH a bundle of rights: chose in action, right to vote, and a certain right to proportionate part of assets (dividend or distribution of assets in winding up)
Preferred Shares: An equity security that resembles properties of both an equity and a debt instrument and generally considered a hybrid instrument. They usually carry no voting rights, but may carry priority over common stock in the payment of dividends and upon liquidation. They also can carry an obligation to pay dividend, albeit it not at a fixed rate, and it can be missed with less repercussions than a bond dividend. Preferred stock may have a convertibility feature into common stock.

Authorized Capital: Amount of capital that, by its constitutional documents, the CO is authorized to issue. Indicates limit of shares that may be issued by directors, showing the potential for dilution of value of individual values.
Issued Capital: The part of authorized capital that has been issued
Leverage: The ability to use other people's capital (debt) to gain an income. Debt securities give you large leverage, allowing you to keep any profits over the interest payment owing. The trade-off to leverage is the high risk.
Financial Covenant: Part of the conditions of a loan agreement, these are the promises by the Board of the borrowing CO to adhere to certain limits in the CO's operations.

Typical characteristics of debt securities:
- They must be in bearer form, or be registered in name of owner
- Obligation to pay interest at a fixed rate, which may be represented by tear-away coupons
- There is a stated maturity date on which the principal is payable
- Debt securities carry no voting rights in election of directors.
- May have provision for gradual reduction of principal amount of security outstanding à provided by "sinking fund"
- The terms carried by a debt security can be established by an "indenture" which is a K between the CO and a trustee for the holders of the security. These provisions may vary widely.
- May be redeemable prior to maturity date
- Unless convertible into shares, debt securities are fixed in amount and offer no growth possibilities
- Relative to equity securities, debt securities offer a higher degree of safety and steady income.
- Holders of debt securities are seen as creditors of issuing CO,
- In the event of a default, holders can initiate proceedings for receivership, bankruptcy or reorganization except to the extent limited by the indenture

Long term Debt Financing is appropriate only if follow conditions are present:
- Earnings base has proven record of stability and is strong enough for debt service obligations.
- Pro forma net tangible assets (the estimated net tangible assets the CO will have if contemplated transaction is completed) are substantially more than the pro forma long-term debt
- Would be lowest cost of capital over other options
- Sufficient security avail.

Convertibles & Other Hybrid Securities

- Both debentures and preferred shares are often made convertible at option of holder into common shares at a specific rate (usually such that at outset it's worth more as debenture or preferred share than common shares)
- Value of conversion privilege lies in the possibility of appreciation of common shares, making them more valuable.
- Convertible securities:
  - Typically made redeemable
  - Conversion privilege continue after notice of redemption is given to fixed date for actual redemption
  - Require carefully drafted provisions against "dilution" of conversion privilege through stock splitting.
- One can create debt securities with characteristics of shares and vice versa
- The mot common hybrid is an "income" bond or debenture, which is a debt security on which interest is payable only to the extent covered by corporate earnings, making it less risky for the CO.

461.2 Corporate Capital Structure

Factors Influencing Decisions on Capital Structure

- One must balance number of factors to decide what sort of a capital structure works best for each CO.
- For every CO there's an optimum capital structure that will assist management in achieving the goal of SH wealth maximization.
- This is based on the assumption that an optimum combination of different models of financing will minimize the CO's cost of capital and in turn benefit SHs.
- The degree of protection required by lenders usually depends on the nature of the CO's business and the related risks.
- Debt lenders will try to control the situation through the use of covenants. The better the credit rating becomes, the less covenants will be needed.
- The most common covenants are for: Dividends, Debt, Liens, Related Party Transactions, Asset Sales, Change of Control.

	Advantages	Disadvantages
Long Term Debt	• Interest on these can be deducted for tax purposes, which results in lower cost of capital for debt. • Debt is not permanent and is eventually redeemed. • Debt doesn't dilute control though equity ownership. • Financial leverage. • Avoids the necessity to issue common equity when in unfavourable market conditions, or if sale would present control problems.	• Tax deductions will not be equally valuable to all COs. • Debt is only a temporary capital. • Heavy drain on cash flow if CO has mandatory sinking fund payments. • Possible onerous limitations from restrictive trust indenture provisions • Interest obligations are fixed charges, and failing to meet them leads to default. • The higher debt/ratio of a CO, the higher the risk, the higher the interest cost.
Preferred Shares	• Maintain a balanced capital structure. • Preferreds are used to improve borrowing base, while avoiding obligation of fixed interest payments. • Can result in more earnings for common SHs • Raises permanent capital without dilution of earnings or voting control. • More flexible than debt as they typically have no maturity. Cheaper than debt if they have low apparent tax rate. • Cost of preferred share financing follows interest rate levels, not P/E ratios.	• Preferreds are expensive since the dividends are paid out of after-tax money. • Dividends can be deferred, but there is a strong pressure to pay. Failure to do so will damage credit rating. • Preferreds are more restrictive than common shares. • Can reduces drastically the earnings for common SHs.
Common Shares	• No payments of fixed charges, no legal obligation to pay dividends. • No repayment of capital. • Increased equity base provides a cushion for losses for creditors, therefore increase credit-worthiness of CO. • Very marketable under certain market conditions. • Avoids encumbrances and trust deed restrictions seen in debt financing. • Appropriate for COs with wide fluctuations in revenues and earnings • Increased number of shares often improves SH liquidity and marketability. • Initial offering gives issuer the numerous advantages that come with "going public"	• Common share financing is often the most expensive method of financing. • Existing SHs suffer from proportionate dilution of earnings per share and voting control. • There is no financial leverage. • When P/E multiple (price of CO shares/ earnings per share) is low, then cost of common share financing is high.

Securities Regulation

All security laws have same fundamental basis: protection of public interest in the efficient operation of the capital market.

- There are two things to balance when designing a system of regulation: trust and efficiency (which relies on access).
- The Canadian system emphasises trust over efficiency.
- Maintaining efficiency of the market is necessary so that buyers and sellers of securities will desire to use market.
  - Buyers must have faith in the promise of being paid in exchange for parting with their cash.
  - Sellers must have faith in info the market is providing them.
- It is believed that buyers and sellers will have faith in the market if the market has integrity.

There are three kinds of efficiency:
- Allocational Efficiency
  - Allocates capital to users in a way that those who are best able to use of capital will get the capital first.
  - This would create the ability of one opportunity to attract the funds before a seller has to create a opportunity that offers a lower "risk adjusted" return or a poorer "risk-return combination"
  - Policy objective is that What is profitable to one individual is not necessarily what is best for the nation.
  - Allocational efficiency is more important in the primary markets.
- Operational Efficiency
  - Market with low transaction cost allows investors to easily transfer their investments from one user of capital to another.
- External Efficiency
  - Has to do with activities of outsiders - investors and savers who are not brokers or dealers
  - This has to do with information and prices. A market where prices fully reflect the information available is externally efficient. This means that the market is open and the changes in price directly and immediately reflect the honest and reliable information provided about the COs.
  - Information must be freely available for this to work.
- Allocational efficiency needs both Operational Efficiency (to ensure that market prices are not distorted due to high and unstable transactional costs) and External Efficiency (to ensure that market prices accurate reflect the info available).
- Also, cheap transactions and fair prices inspire confidence in investors, causing them to invest and trade more frequently and to suit the changing times. This encourages investment and brings down the cost of capital for COs.

Types of regulation

- To maintain market integrity, most systems will regulate participants in the market, the securities in the market, and the info available in the market.

- Regulation of the participants in the marketplace
  - Sellers of securities: This is pretty straightforward. They are required to register with regulatory authority, meet and maintain standards, and comply with regulations governing info to be made available to the market.
  - Buyers of securities: from retail investors to institutional investors, these need to be regulated, to prevent investor disappointment in the market. The larger the investor (more assets they control) the more sophisticated it is presumed, and the less information flow towards them is regulated. Smaller investors are protected by more onerous disclosure regulations..
  - Intermediaries: these are not interested in the outcomes of the transactions, since they make money on any transaction. They also have a power to make the market inefficient.
- Regulation of the securities in the marketplace.
  - There was not much regulation in this area, but recently there has been plenty of talk of need for more stringent regulations, such as the issues with the asset backed commercial papers.
  - There is no limit on creation of securities, but certain securities may be limited from sale because
    - Prohibited securities prone to being abused, and impugn integrity of market
    - Some securities are too complicated to be understood by intended buyers.
    - This has been somewhat regulated by the "know your client rule" which prohibited brokers from buying securities which were inappropriate for their clients.
- Regulation of information available in the marketplace.
  - Buyer and seller must have all info which may affect share value.
  - Liability for failing to disclose, or disclosing the incorrect info.

461.3 Securities Regulation

Sources of regulation

- In USA there are state security laws that are the basis for the blue sky commissions. But there is a provision that any CO that is listed on an exchange is exempt from state provisions. These are controlled by the SEC, which is the de facto regulator.
  - This came about as the result of the Great Depression, where the states were seen as unable to deal with the crisis using a patchwork of state laws.
  - Feds managed to bring in a federal regulating agency under interstate commerce and postage laws, which are under federal jurisdiction.
- In Canada, each province and territory has a securities regulator and statute, and there is no federal regulating agency.
  - This is clearly a shitshow.
  - Most commonly transactions will fall under twin jurisdiction: the province where the CO originates, and ON, which is where most lenders or buyers are, or (in the case for listed COs) where the TSX is. There is substantial similarity between provincial laws and ON laws, but in case of the conflict, both sides will usually prefer a different *Securities Act*.

Sources of Regulation in BC:
- *Securities Act,* RSBC 1996 (*BCSA*)
- Regulation to the BCSA
- Rules to BCSA
  - Only *BCSA* (including *Rules* and *Regulations*) have the force of law. These are administered by BCSecCom.
- By-laws and rules of Self-Regulatory Organizations.
  - By-laws and rules of Self-Regulatory Organizations do not have force of law, but the *BCSA* authorizes BCSecCom to delegate to them the regulations. Which means that their breach will be treated like breach of law.
- National Instruments of the provincial securities administrators (NIs and MIs) that have force of law.
- Policy Statements of the provincial securities administrators. (NPs and Uniform Policies)
  - Like by-laws, have no force of law but breach can be treated like breach of law.

British Columbia Securities Commission

- Note that most of this applies to ONSecCom, or any other SecCom in Canada.
- BCSecCom is an independent, autonomous, administrative tribunal, and the general powers of administrative tribunals apply.
- The mandate of the BCSecCom is to protect the investing public from reprehensible activities such as fraud, manipulation, & misconduct in the marketplace.
- Ensure investors have full, true, and plain disclosure of material facts in disclosure documents relating to publicly-offered securities, and accurate continuing info to assist investor to arrive at informed investment decisions in secondary market transactions
- New *BCSA* contains examples of recognition of special expertise of the SecCom, and its need to be able to respond relatively quickly.
- It is hard to pinpoint practice of BCSecCom because decisions are rarely available in writing, and practices may change without notice.

- BCSecCom is responsible to the Lieutenant Governor (LG) through the Minster of Finance. LG has power to appoint and remove by order-in-council any of the commissioners from office, and make regulations effecting many provisions of the Act
- It is made up of seven members, one of whom is Chairman & CEO of the SecCom.
- Chairman is expected to serve on full-time basis, while others are part-time.
- There are no particular qualifications, but it is generally desirable to have legal background.

- BCSecCom has the power to grant, suspend, and cancel registration of COs.
- It imposes a fair standard conduct in dealings between parties (often issuing policy statements to meet a perceived abuse).
- SecCom can delegate its power to the Superintendent (CEO)
- Any decision of Superintendent can be appealed once and reviewed, but these are final and cannot be appealed again.
- Any person directly affected by decision can appeal but only with leave of a justice of that court
- Decisions of SecCom and its Executor Director generally are only applicable to parties to the decision.

In the Matter of Canadian Tire CO [1987] ON SecCom

Security Commissions will get involved in transactions that endanger public interest, even if they are not in breach of the Securities Act.

Facts: Canadian Tire CO had two classes of shares: common stock, which made up 4% of the outstanding capital, and the Class A, which had no voting rights, which mad up the rest. The 60% common shares was held by the three siblings of the Billes family, who were the children of the founder of the CO. 20% of the common shares were held by Dealers, which was a holding CO representing the Canadian Tire Dealers Association. The Billes restructured the shares in 1983, raising money for the CO, and including a provision that in the case of the takeover bid for the majority of the common shares, the Class A shares will be converted to the common shares, thus diluting the votes. This held the power in the hands of the Billes. But two years later they began to fight among each other, and could no longer control the CO efficiently, and decided to sell off their shares. Dealers were interested in purchasing them. But Dealers did not want to face the conversion of the Class A shares that would be triggered by the bid, so together the Billes and the Dealers came up with a scheme to bid for 49% of the shares, which is not the majority, will not trigger the conversion, but would still give the Dealers the controlling seat. ONSecCom issued a stop order saying that this was in violation of the s.123 of the *ONSA* (now s.127) as it was against public interest.

Issue: Is this against public interest?

Discussion:

- There is nothing here that is in breach of the *ONSA* or any other public regulations.
- But SecCom has previously committed itself to getting involved in dubious transactions, even if they are legit on paper.
- The bid here was designed to purchase all the common shares held by the Billes, but structured so as to avoid the take-over protection applicable to Class A shares. SecCom found this to be sufficiently abusive and against public interest.
    - Canadian tire is one of the largest Canadian COs
    - The conversion provision was brought in by the Billes themselves only 3 year prior.
    - This attracted investors to buy Class A shares, as they now afforded more protection.
    - Now, the Billes have cunningly come up with a scheme to circumvent this.
    - Allowing this would endanger the respectability and the faith in the market.
- Commission will restrain transactions that are clearly abusive of investors and capital markets, whether or not they constitutes breach of Act, regulations, or policy
- The broad discretionary power of the SecCom have been upheld by the ON courts

Ruling: The stop order is upheld.

Coattail Provision: In the event of a takeover offer for a CO, this provision allows the holders of the non-voting or restricted voting shares the right to convert their shares into an equal number of the superior voting shares. There is a policy in the TSX manual about the Coattails, which is designed to counteract the sort of screwing around as happened in *Canadian Tire.*

Self-Regulatory Organizations

- Another source of regulation is from industry associations.
- An arrangement under which an industry association is looked to by a government agency to apply controls over its members in the public interest, in circumstances where the agency might otherwise apply such controls directly.
- TSX is the most important one of these for the matters of this course. Others are the Investment Dealer's Association of Canada, Canadian Mutual Funds Association
- Advantages for effective system:
    - Government agency can devote resources to other activities
    - Industry association may be able to employ more effective disciplinary techniques than government agency
    - Business practices and moral standards are more readily understood by people in the industry
    - Industry association can be organized on a national basis without any constitutional difficulties
- The problem with Self-Regulatory Organizations is they have no power of enforcement besides for kicking the guilty party out (delisting, in the case of TSX).
    - But this will fuck over the investors of the delisted CO, and since SecCom is a fan of public interest, it is most rare.
    - So Self-Regulatory Organizations will usually go to the relevant securities regulator prior to the extreme punitive action of delisting
- TSX has two major sets of rules: one applying to TSX, the other to TSXV.
- Regulation Services for TSX is the outsource policeman for continuous disclosure.

461.4 Take-over Bid Regulations

Regulation of Take-over Bids, Issuer Bids, and Insider Bids

When it comes to take over bids, the regulators are concerned with the rights of the holders of common shares of the target CO, and any other securities (preferred shares and debt) that have a conversion right.

- Once again, the principal cause for the regulation is to protect the public interest for those involved in the market
- The primary legislative focus for the take over bid regulation is to protect the interest of the offeree CO's SHs
- In BC, these are governed by the Multilateral Instrument 62-104, and Part XIII of the *BCSA*.

Offeror: The person that makes a take-over bid, and issuer bid, or an offer to acquire.
Offeree: The CO whose securities are the subject of a take-over bid, an issuer bid, or an offer to acquire.
Issuer: A person who has issued, is issuing, or is planning on issuing a security.
Reporting Issuer: Means an issuer that

- has filed a prospectus or statement of material facts and the executive director has issued a receipt for it under this Act,
- has any securities that have been at any time listed and posted for trading on any exchange in British Columbia.

Take Over Bid: Means an offer to acquire outstanding voting or equity securities of a class made to one or more persons, where the securities subject to the offer to acquire, together with the offeror's securities, constitute in the aggregate 20% or more of the outstanding securities of that class at the date of the offer.

- The offeree must be in the local jurisdiction.
- This does not include an offer to acquire if the offer to acquire is a step in an amalgamation, merger, reorganization or arrangement that requires approval in a vote of security holders.

Issuer Bid: An offer to acquire or redeem securities of an issuer made by the issuer to one or more persons, in the local jurisdiction. This does not include an offer where

- No valuable consideration is offered or paid by the issuer for the securities,
- The offer to acquire or redeem, is a step in an amalgamation, merger, reorganization or arrangement that requires approval in a vote of security holders, or
- The securities are debt securities that are not convertible into securities other than debt securities;

Material Change: If used in relation to an issuer other than an investment fund, it is

- A change in the business, operations or capital of the issuer that would reasonably be expected to have a significant effect on the market price or value of a security of the issuer, or
- A decision to implement such change made by the directors of the issuer

Material Fact: Means, when used in relation to securities issued or proposed to be issued, a fact that would reasonably be expected to have a significant effect on the market price or value of the securities.

Prospectus: Legal document that institutions and businesses use to describe the securities they are offering for participants and buyers. A prospectus commonly provides investors with material information about shares, such as a description of the CO's business, financial statements, biographies of officers and directors, detailed information about their compensation, any litigation that is taking place, a list of material properties and any other material information.
Circular: The information booklet that is distributed during the TOB. Separate circulars are issued by the offeror (62-104F1), issuer (62-104F2), and the directors of the offeree CO (62-104F3). Those issuing the circular are liable for misrepresentation in it.
Notice: A formal or written notification required by law.

Open Lock-up Agreement: An agreement whereby a offeree SH grants an option to the offeror to purchase his shares, thus ensuring a foothold for the offeror. An open lock-up allows offeree to withdraw if a better offer comes along.
Hard Lock-up Agreement: Same as above, but unconditional

Take-over bids are only triggered when SH, as a result of an offer to SHs, will hold more than 20% of equity shares.
Examples:

- X owns 9% of shares of CO. X then purchases 5%, then another 5%. This is not a TOB
- X owns 9% and enters into an agreement to buy 12% more share from the CO. This is not a TOB, as X buys the 12% from the CO, not the secondary market.
- X owns 16% of the common shares and 14% of the preferred shares. X purchases another 16% of the preferred shares. This is not a TOB, as the preferred shares are non-voting.

MI 62-104 Take Over Bids and Issuer Bids

- Multilateral Instrument 62-104 Take-Over Bids is the harmonized and consolidated take-over policy across all Canadian provinces other than ON.
- In ON there is the OSC Rule 62-504, which is very similar to this.

Definitions and Interpretation

1.8 Deemed beneficial ownership

- In determining the beneficial ownership, the offeror (or any person acting in concert) is deemed to be beneficial owner of an equity security (including unissued ones) if:
  - The person is the owner of a convertible security that can be converted into equity security within 60 days.
  - The person has a right or obligation permitting or requiring him to acquire equity securities within 60 days.
- If two or more offerors are acting jointly, the securities that they plan on acquiring are deemed to count wholly towards each offeror's 20% margin.
- This will not be deemed if the acquisition is a part of a lockup agreement in the context of a tendering process.

1.9 Acting jointly or in concert

- It is a question of fact as to whether a person is acting jointly or in concert with an offeror.
- People are deemed to be acting jointly or in concert, so that this presumption cannot be rebutted, where
  - There is an agreement, commitment or understanding, to acquire or offer to acquire securities of the same class.
  - The other party is an affiliate of the offeror (offeror has >50% ownership)
- People are presumed to be acting jointly or in concert, so that this presumption can be rebutted, where
  - There is an agreement, commitment or understanding, and intention to exercise voting rights
  - The other party is an associate of the offeror (offeror has >10% ownership).
- This will not be deemed if the acquisition is a part of a lockup agreement in the context of a tendering process.

Restriction on acquisition or sales

2.2 Restrictions on acquisitions during take-over bid

- From the day of the announcement of the TOB until the expiry of the bid, an offeror must not offer to acquire (or make an agreement, commitment or understanding to acquire) any securities of the class that are subject to a TOB (or convertible into them) otherwise than under the bid.
- Exceptions to this:
  - The intention of the offeror is to make purchases and that intention is stated in the bid circular or a news release.
  - The number of securities does not exceed 5% of the outstanding securities of that class;
  - The purchases are made in the normal course on a published market;
  - The offeror issues and files a news release immediately after the close the market on each day on which securities have been purchased under this subsection disclosing the following information:
    - Name of purchaser
    - Number of securities
    - Highest price paid.

2.4 Restrictions on acquisitions before take-over bid

- Pre-bid integration rules are concerned with the transactions made in the 90 days prior to the bid.
- This will be triggered if an offeror has purchased shares within 90 days before the TOB, in a transaction not generally available on identical terms to holders of that class of securities
- The offeror has to offer the highest consideration paid and acquire the percentage of securities equal to highest percentage acquired from an individual holder from previous transaction.

- To avoid falling under the pre-bid integration rules, offeror can simply wait 90 days before making the bid.
- But the problem with this is that due to disclosure requirements, the market will get a notice of someone putting themselves into a TOB position, and will trade the shares up in anticipation of the bid.

2.5 Restrictions on acquisitions after bid

- For 20 business days after the expiry of a bid, whether or not any securities are taken up under the bid, an offeror must not acquire or offer to acquire securities of the class subject to the bid, except by way of a transaction that is generally available to holders of that class of securities on identical terms.

Pre-bid Integration Rules Example:

CO has 1,000,000 shares outstanding. X started out with 1,000 (10%) at FMV of $10.00 and bought an additional 900 (9%) from the other SHs.

- SH1: Held 600 shares, X bought 300 shares for $11.50 (50% of shares held by SH1)
- SH2: Held 400 shares, X bought 100 for $10.50 (25% of shares held by SH2)
- SH3: Held 600 shares, X bought 200 for $14.00 (33.3% of shares held by SH3)
- SH4: Held 150 shares, X bought 100 for $10.00 (66.6% of shares held by SH4)
- SH5: Held 200 shares, X bought 200 shares at $12.00 (100% of shares held by SH5)

- There is no TOB issue yet, as X has less than 20%.
- If X wants to buy more shares, would have to offer to buy 100% of all the shares (highest percentage of shares bough from individual holder in the past 90 days) and at price of minimum $14.00 (highest bid price in the past 90 days).

Making a Bid

2.8 Duty to make bid to all security holders

- Offeror must make the bid to all SHs of the class of securities in the local jurisdiction.

2.9 Commencement of bid

- Offeror must commence the bid by publishing an ad in a major daily newspaper, and by sending the bid to all SHs

2.10 Offeror's circular

- An offeror making a bid must prepare and send, a bid circular, of either 62-104F1 (TOB) or 62-104F2 (Issuer Bid)

2.11 Change in information

- If there is a material change, offeror has to issue notice of change to TOB circular.

2.12 Change in terms of bid

- If there is a variation in the terms of the bid, the offeror must issue notice of change.
- If this is done in less than 10 days prior to expiry of the bid, the bid must be extended to expire at least 10 days after notice of change is issued.

Offeree issuer's obligations

2.17 Duty to prepare and send directors' circular

- The Board of the target CO bears responsibility to inform their SHs when a TOB has been made
- Thus, the Board has 15 days to evaluate the offer and then to send out the Director's circular.
- This circular must do one of three things:
  - Recommend SHs to accept or reject the bid
  - Advise that the Board will not be giving a recommendation and give reasons why
  - Advise that the Board is still considering the bid and will give recommendation before bid is finalized.

2.18 Notice of change

- If there is a material change to the nature of the bid after the circular has been issued, the Board has to inform the SHs with a notice of change.

2.20 Individual director's or officer's circular

- The CO must publish dissent views of any directors.

Offeror's obligations

2.23 Consideration:

- Offeror must offer the same consideration to all SHs of target CO.
- If offeror raises offer price, he must pay the SHs who already tendered their bid the raised price.

2.27 Financing arrangements

- The offeror has to have his financing arranged prior to making the bid.

2.24 Prohibition of Collateral Benefit:
- If someone intends to make TOB, he or anyone acting jointly with him, cannot enter into collateral agreements that have the effect of providing a SH with greater consideration than other SHs of the same class of securities.
- So no sweetened offers of tropical vacations, or parties with hookers and blow
- This doesn't apply to some employment compensation, severance or other employment benefit arrangements.
- This doesn't apply if offeror tries to induce directors or executives to stay with the company after take-over

2.26 Proportionate Take Up and Payment:
- If a bid is made for less than all of the class of securities subject to the bid and a greater number of securities is deposited than the offeror is bound or willing to acquire, the offeror must take up and pay for the securities proportionately, disregarding fractions, according to the number of securities deposited by each security holder.
- If X wants to buy 500,000 shares, and is offered 800,000 altogether, X cannot pick and chose from which SHs to purchase. He must buy the proportionate amount of shares from each SH (5 shares out of each 8 shares offered).

Bid mechanics

2.28 Minimum deposit period
- Offers must be outstanding for at least 35 days so directors in target CO can reasonably consider the offer and also try to find other bids.

2.29 Prohibition on take up
- An offeror must not take up securities deposited under a bid until the expiration of 35 days from the date of the bid.

2.30 Withdrawal of securities
- A SH may withdraw securities deposited at any time before they are taken up by the offeror.
- If the securities have not been paid for by the offeror within 3 business days after the securities have been taken up.
- There are some exceptions to this, but they seem marginal.

2.32 Obligation to take up and pay for deposited securities
- If all the terms and conditions of a bid have been complied with or waived, the offeror must take up and pay for securities deposited under the bid not later than 10 days after the expiry of the bid.
- Offeror must pay for all securities take within 3 business days of taking them.
- Any securities deposited after the offeror began to take up securities must be taken up no later than 10 days after their deposit.
- An offeror may not extend its bid if all the terms and conditions of the bid have been complied with or waived, unless the offeror first takes up all securities deposited under the bid and not withdrawn.

2.33 Return of deposited securities
- Offeror must return all shares that are not taken up, or that he knows that he will not take up.

2.34 News release on expiry of bid
- Offeror must notify the market when bid has expired.

Exemptions

4.1 Normal course purchase exemption
- Acquiring less than 5% of the shares at FMV makes one exempt from the TOB rules. There are 4 conditions to satisfy:
  - The bid is for less than 5% of the outstanding securities of a class,
  - Aggregate number of securities acquired in reliance on this exemption by the offeror and persons in concert in last 12 months, is less than 5% of the securities
    - Only percentage in excess of 20% counts in the 5%. If X who is at 19% then entered into agreement with a SH to buy 5% leaving X with 24%, only 4% of the 5% acquired counts under this exemption.
  - There is a published market for the class of securities that are the subject of the bid;
  - The value of the consideration paid for any of the securities is FMV.
- The period is counted from the last purchase of shares within the last 12 months.
- This can be used repeatedly year after year to incrementally creep up one's position.

4.2 Private Agreement Exemption

- Acquiring less than 5% of shares at less than 115% of FMV makes one exempt from the TOB rules. Yet again it takes four conditions to satisfy this:
  - Purchases are made from less than 5 people,
  - Bid is not made generally to SHs of that class (so long as there are more than 5 security holders of the class),
  - If there is a published market for the securities acquired, price paid must less than 115% market price, based on a 20 day average.
  - If there is no published market for the securities acquired, there has to be a reasonable basis for determining that the price paid less than 115%.
- No cap on share percentage owned, as in 4.1. So this enables "creeping" TOBs.
- Allows unequal treatment of SH by giving room for 15% control premium in the private purchase agreements.
  - However, if the shares exchanged here give someone a control position, the offeree will probably want much more than a 15% control premium. Standard practice can go as high as 300%.
- If an offeror knows or ought to know that the person selling the shares has acquired them to sell them under this exemption, then all the people that that person bought the shares from will count towards the "5 person" limit.

Combining the Exemptions:

- 4.1 has a time rule, so an offeror should purchase under 4.1, then turn to 4.2 if he wants to purchase even more shares.
- One may also use 4.2 more than once, according to some lawyers.
- BCSecCom are trying to limit this practice.

4.3 Non-reporting issuer exemption

- Private COs that has no listed shares and no disclosure obligations, are exempt from TOB.

4.4 Foreign take-over bid exemption

- Where less that 10% of outstanding equity interest is held by Canadians (as per addresses in offeree's books)

Reports and announcements of acquisition

5.2 Early warning

- Any acquisition that puts a SH over 10% limit obliges him to issue a press release and within 2 business days file a report as per NI 62-103
- Any subsequent acquisition of additional 2% requires a further round of notice.
- The investor cannot trade the security for a day after having made the release, to allow the markets to digest the information. This does not apply to those who have more than 20%.

5.3 Acquisitions during bid

- If there is a bid in progress, and a SH acquires shares that put him over 5%, he must issue a news release, containing his name, his position, his purpose, and the market where the shares were traded.
- Any subsequent acquisition of additional 2% requires a further round of notice.

Most of the same rules applicable to take over bids are also applicable to issuer bids. But these are not on the exams, so they can go fuck themselves.

- Unlike the TOB scenario, where the offeror approaches SHs directly, the following transactions require approval by the Board, as well as a special resolution by a general SH vote. None of these are also on the exam.

Amalgamation: A statutory means of combining two or more COs into a single CO.
Arrangement: A court approved scheme of arrangement is an agreement between a CO and either the holders of its securities or its creditors. Examples of when schemes of arrangement may be used include rescheduling debt, for TOBs, and for returns of capital. When used for a TOB, a scheme of arrangement can only be used for an friendly bid, because the application to the court must be made by the company whose shares are being re-organised: the target.
Share Consolidation: A share consolidation is the opposite of a share split. Each SH's shares are replaced with a smaller number of shares with a higher par value. If a shareholder has a 1,000 shares with a par value of $10, then after a 1 for 2 consolidation the shareholder will have 500 shares with a par value of $20.

Liability Under BC Securities Act

- Under s.114, an aggrieved party can go to BCSecCom and get an order to stop or set aside the transaction.
- Under s.115, an aggrieved party can also apply to Supreme Court to order damages or rescission.

132 Liability for misrepresentation in circular or notice

(1) If a take over bid circular, issuer bid circular, notice of change or notice of variation is required to be sent under the regulations and that document contains a misrepresentation, a person to whom the circular or notice was sent is deemed to have relied on the misrepresentation, and has a right of action for

(a) rescission against the offeror, or

(b) damages against

(i) each person who signed the certificate in the circular or notice,

(ii) every director of the offeror at the time the circular or notice was signed,

(iii) every person whose consent has been filed as prescribed, and

(iv) the offeror.

(9) The liability of

(a) all persons referred to in subsection (1) (b), or

(b) all directors and officers referred to in subsection (3),

is joint and several as between themselves with respect to the same cause of action.

- Pretty much the same provisions are in s.131 for misrepresentation on a prospectus.
- The onus is on D to absolve himself of any liability for misrepresentation, in accordance with defences in s.132(4)-(7).
- There is a limitation of 150 days for rescission. Because of this, people will often wait and see if the shares make money, even despite a faulty circular.

136 Liability for Insider Trading

(1) If an issuer, or a person in a special relationship with an issuer, contravenes section 57.2, a person referred to in subsection (2) of this section has a right of action against the issuer or the person in a special relationship with the issuer.

(2) A person may recover losses incurred in relation to a transaction involving a security of the issuer, or a related financial instrument of a security of the issuer, if the transaction was entered into during the period

(a) starting when the contravention occurred, and

(b) ending at the time the material fact or material change is generally disclosed.

(3) If a court finds a person liable in an action under subsection (1), the amount payable to the plaintiff by the person is the lesser of

(a) the losses incurred by the plaintiff, and

(b) an amount determined in accordance with the regulations.

(4) For the purposes of subsection (1), in determining the losses incurred by a plaintiff, a court must not include an amount that the defendant proves is attributable to a change in the market price of the security that is unrelated to the material change or the material fact.

161 Enforcement orders

(1) If the commission or the executive director considers it to be in the public interest, the commission or the executive director, after a hearing, may order one or more of the following:

(b) that [a person] cease trading in, or be prohibited from purchasing, any securities or exchange contracts, a specified security or exchange contract or a specified class of securities or class of exchange contracts;

(d) that a person ... resign any position that the person holds as a director or officer of an issuer, registrant or investment fund manager,

155 Offences Generally

(1) A person who does any of the following commits an offence:

(a) fails to file, provide, deliver or send a record that

(i) is required to be filed, provided, delivered or sent under this Act, or

(ii) is required to be filed, provided, delivered or sent under this Act within the time required under this Act;

(b) contravenes any of section 34, 49 to 57, 57.2, 57.3, 57.5, 57.6, 58, 59, 61, 85 (b), 86 to 87.1, 121, 122, 124, 125, 148 or 168.1 (1) of this Act;

(c) fails to comply with a decision made under this Act;

(d) contravenes any of the provisions of the regulations that are specified by regulation for the purpose of this paragraph;

(e) contravenes any of the provisions of the commission rules that are specified by regulation for the purpose of this paragraph.

(2) A person that commits an offence under this Act is liable to a fine of not more than $3 million, or to imprisonment for not more than 3 years, or both.

Statutory defences

132 Liability for misrepresentation in circular or notice

(4) A person is not liable under subsection (1) or (3) if the person proves that the person exercising the right of action had knowledge of the misrepresentation.

- s.132(4) is the only defence that is available to the offeror. There are two more that are applicable to the issuer.
  - That the person did not consent to the circular, or upon becoming aware of the misrepresentation, withdrew the consent (s.132(5)(a)(b))
  - The circular was made by an expert and the person had no reasonable grounds to believe there was a mistake.
  - That the due diligence standard required to be met by the person was met (s.132(5)(6)(7))

133 Standard of Reasonableness

In determining what is a reasonable investigation or what are reasonable grounds for belief for the purposes of sections 131 and 132, the standard of reasonableness must be that required of a prudent person in the circumstances of the particular case.

136.2 Due Diligence for Insider Trading

A person is not liable under section 136 or 136.1 (1) if, after a reasonable investigation occurring before the person

(a) entered into the transaction,

(b) informed another person of the material fact or material change, or

(c) recommended or encouraged a transaction,

the person had no reasonable grounds to believe that the material fact or material change had not been generally disclosed.

Disclosure Requirements in Securities Transactions

Disclosure requirements

These are provided in the back of MI 62-104 and have been partially discussed above, so here's a quick recap.

62-104F1 Take Over Bid Circular, 62-104F2 Issuer Bid Circular

- MI 62-104: 2.10 creates an obligation of offeror to deliver TOB or IB circular that follows the prescribed form.
- It must contain certificate signed by CEO, CFO, and two other directors of the offeror. The certificate state that the circular contains no untrue statement or omission of a material fact.
- Offeror or issuer must inform the target SHs of all material info.
- There is a difference between TOB circulars that are made for cash offers (which are simpler) and equity offers (which require prospectus level disclosure from the offeree and disclose pro-forma FSs).

62-104F3 Director's Circular

- This is issued as a response to a TOB circular; statement of defence.
- MI 62-104: 2.17 obliges the offeree CO's Board to deliver the Director's Circular within 15 days of date of bid.
- MI 62-104: 2.17(2) In the circular, the Board must recommend one of three options: accept the offer, reject the offer, or make no recommendation, and give reasons for their decision.
- MI 62-104: 2.20 obliges the CO to publish dissent views of any directors.

62-104F5 Notice of Change or Notice of Variation

- MI 62-104: 2.11 Notice of change in info is required, whenever there is a variation of terms, or material change to the offer or the circumstance of either of the COs. It must also follow prescribed form, and be signed signed as above.
- Notice of Change is needed if material change in facts has occurred. This must be filed by the offeror.
- Notice of Variation has no materiality qualifier. If any terms are varied, even the most minor ones, require notice of variation.
- The notice must be in a mailed circular or published as an advertisement in newspaper. Timing is very important.

In the matter of Royal Trustco Ltd, K. White, and J.M. Scholes [1981] ON SecCom
Sample case about duty to disclose and update, as well as illegality of tipping.

Facts: Campeau Inc. embarked upon a take over bid for Royal Trustco, of which White and Scholes were President and CEO. Royal Trustco was against the bid, and W&S undertook a number of defensive tactics to stop the bid. This included canvassing major SHs and getting them to promise not to tender their shares. W&S also attracted investors to take significant positions in Trustco, to further consolidate the shares in the hands of their allies. Campeau made a bid at $21 per share, conditional on 50% of the shares being tendered. Trustco responded with a proper circular. After that W&S continued getting assurances that major SHs will not tender. They disclosed to the Board that 41% of the shares will not be tendered, and then later to TD Bank Board (one of the investors) that 60% will not be tendered. When Campeau extended the bid increased to $23 per share, W&S did not include any of the information about informal agreements in the circular. In the end, the bid failed, with only 25% of shares being tendered.
Issue: Did W&S's failure to disclose the assurances that 60% of shares will not be tendered breach the disclosure requirements, and prevent SHs from doing the right thing?
Discussion:
- Directors are obliged to send Directors' Circular to SHs within 10 days of the offer.
- Section 165 of Regulations requires directors to state the particulars of any other info not disclosed in the foregoing but known to the directors which would reasonably be expected to affect the decision of SHs of the offeree CO to accept or reject the offer
- During the period of distribution, where a material change occurs, an amendment must be filed to the prospectus within 10 days of change
- The information that shares will be withheld from tendering, albeit not official, and not absolute, was material, since when used in relation to securities issued or proposed to be issued, it was a fact that would reasonably be expected to have a significant effect on the market price or value of the securities.
- Ditto for the information that investors, such as TD Bank, have purchased shares in Trustco with the intention of withholding them.
- W&S also failed to disclose the nature and extent of their defensive tactics.
- Furthermore, persons in a special relationship disclosing to TD Bank Board the material information that has not been disclosed elsewhere is illegal per s.75 of the *ONSA* (at the time). This is called tipping.
- If SHs would have known all of this, they would have been sure that the bid is doomed to failure, and would have likely not tendered their shares, but sold them on the market at an inflated price.
- As a result of all of this, SHs of Trustco were deprived of sufficient information upon which to base their own investment.

Ruling: W&S are guilty.

Sparling v. Royal Trustco Ltd [1984] ON CA
Duties and liabilities of directors where corporate actions during takeover bids are questionable.

Facts: Same case as the one above. The action arose from a take-over bid made by Campeau Corporation for Royal Trustco during the fall of 1980, which was unsuccessful. Following the failure of the bid the PL Director, appointed under s. 253 of the *CBCA*, brought an action on behalf of unnamed SHs, against Royal Trustco and the individual directors of the CO at that time. It was alleged that the Directors' Circular, sent to all SHs as required by the *CBCA*, and recommending rejection of the bid, failed to disclose material facts known to the Ds which were required to be stated in order to make statements contained in the Circular not misleading in the light of the circumstances in which those statements were made.
Issue: What steps can the PL director make to remedy the withholding of information?
Discussion:
- For the purposes of this appeal it was assumed that the allegation of withholding of material information was correct.
- PL was specifically empowered to undertake all of the procedures in s.198(3), including that to obtain compensation for the SHs "aggrieved" by the withholding of information.
- Under s.234, PL was empowered to proceed against the CO with respect to oppressive or unfairly prejudicial conduct.
  - The failure to disclose the requisite information in the circular, which was prepared in their own name but on behalf of the CO, may be unfairly prejudicial to or disregard the interests of the SHs.
- It was therefore appropriate that the action be brought against the CO as well as its directors.
- In the case of take-over bids or where corporate actions are oppressive or unfairly prejudicial to SHs, the Director can and should take steps to protect the public interest. See box below.
- A director has a role of a public protector and broad powers of investigation and intervention on behalf of the public.

Ruling: Appeal allowed.

Responsibility of Directors under CBCA:
In cases of questionable corporate responses to take over bids, directors can do four things:
- Make an application to the court to have a meeting ordered, commence derivative or oppression action, dissolve CO, etc.
- Effect certain actions or directions without applying to the court.
- Rely on certain (discretionary & non-discretionary powers) to issue exemptions (exemptions for "distributing corporation" status, trust indenture, requirement for an audit committee, etc).
- Use certain powers (discretionary & non-discretionary) to issue certificates.

Material Misleading Disclosure: There is a difference between perfect disclosure (which almost never happens), acceptable disclosure, which is not perfect, but not misleading, and material non-disclosure or material misleading disclosure, which omits material facts. The appropriate standard for materiality (as per *Sparling v. Royal Trustco* [1984] ONCA) is that an omitted fact is material if there is a substantial likelihood that a reasonable SH would consider it important in deciding how to vote.

Fait v. Leasco Data Processing Equipment CO. [1971] US
The offeree's SHs are entitled to know the full extent of the deal that they are participating in.

Facts: Reliance, which was an insurance CO was the target of a TOB by Leasco. As an insurance CO, R was stringently regulated, and required to keep a surplus amount of money to ensure its ability to cover all liabilities. Any surplus besides for that was considered "surplus surplus." However, as an insurance CO, R was unable to use this surplus surplus for non-insurance purposes. Leasco developed a scheme, where it would take over R, create a holding CO, and transfer the surplus surplus, which it estimated as $125m, to it to use for non-insurance purposes. It proceeded with the TOB by offering an exchange package of convertible preferred stock and options, in exchange for R's shares. In the TOB circular L did not mention anything about the surplus surplus, its estimated amount, or L's plans for it. Initially hostile directors of R were appeased by L's sweetened offers and guarantees that they retain their jobs. In exchange they recommended that R's SHs accept the offer, despite dubious tax consequences to the SHs. The offer went through and L acquired 90% of R. Fiat was a SH of R, who launched a class action, alleging that L misrepresented their intentions in the circular, by failing to disclose the information about the surplus surplus, which was so important to the overall transaction.
Issue: Did L misrepresent?
Discussion:
- L, as the offeror, has obligation to disclose everything material to the transaction, even the fact that the R was grossly inefficient and had a large amount of surplus surplus.
- The court looked at due diligence portions of *Escott v. BarChris* [1968] US.
- L failed to fulfill their duty of reasonable investigation.
- L had no reasonable grounds to believe that an omission of an estimate of surplus surplus was not materially misleading.
- L's statement was misleading in a material way.

Ruling: Damages for PL.

NP 51-201 Disclosure Standards

- National Policy 51-201 is a best practices guide that provide guidance for "best disclosure" and addresses concerns regarding selective disclosure of material corporate info.
- This is a policy, not an instrument, which means that most of the time there is no strict obligation to do anything here.

2.1 Timely Disclosure
- A CO must disclose a material change in their business within 10 days of the change, even prior to approval by directors.
- The announcements of material changes should be factual and balanced.
- Note that this only applies to the material change.
- This means that a CO does not have to disclose all material facts on a continuous basis.

2.2 Confidentiality
- If the harm to a CO's business from disclosing outweighs the general benefit to the market of immediate disclosure, withholding disclosure is permitted by regulation.
- But the CO must make a confidential filing to the SecCOm

2.3 Maintaining Confidentiality
- Where disclosure of a material change is delayed, a CO must maintain complete confidentiality.
- If the confidential material change, or rumours about it, have leaked or appear to be impacting the share price, CO should take immediate steps to ensure that a full public announcement is made.
- This is in place to ensure that there is no insider trading or tipping.

3.1 Tipping and Insider Trading
- This applies to both material information and material change.
- This is essentially the restating of the insider trading and tipping prohibition from the *SA*
- Anyone in CO, or in a special relation with it, and with knowledge of undisclosed material information shall not trade in it's securities, or advise anyone to trade in it's securities.
- Special relationship is defined in the *SA*
- Nor shall they inform anyone of the undisclosed information, save when this is done in NCOB.
- Because the "special relationship" definition is so broad, it is important that COs establish corporate disclosure policies and clearly define who within the CO has responsibility for corporate communications.

3.3 Necessary Course of Business
- This is the exception to the tipping and insider trading prohibition.
- Whether the event has occurred NCOB is a mixed question of law and fact.
- Disclosure by a CO regarding a private placement may be in the NCOB for CO to raise financing.
- The NCOB exception would not generally permit a CO to make a selective disclosure of material information to an analyst, institutional investor or other market professional, unless if they are "within a chinese wall"
- NCOB exception exists so as not to unduly interfere with a CO's business activities, including communications with:
  - Venders, suppliers, strategic partners on R&D, marketing, and supply contracts
  - Employees, officers, and board members
  - Lenders, legal counsel, auditors, underwriters, other advisers
  - Parties to negotiations
  - Labour unions and industry associations
  - Government agencies and non-governmental regulators
  - Credit rating agencies.

3.4 Necessary Course of Business Disclosures and Confidentiality
- If CO discloses material info under NCOB exception, it must make sure that those receiving info understand that they cannot pass the info onto anyone else, or trade on the info, until it has been generally disclosed.
- This should go beyond a mere confidentiality agreement, as such does not prevent tipping.

3.5 Generally Disclosed
- The tipping prohibition stops a CO from disclosing nonpublic material info to anyone, other than NCOB before the CO generally discloses it.
- "Generally disclosed" is usually considered satisfied when:
  - Info has been disseminated in a manner calculated to effectively reach the marketplace &
  - Public investors have been given a reasonable amount of time to analyze the info
- A CO may satisfy the "generally disclosed" requirement by using one or several of the following methods:
  - Widely circulated news or wire service
  - Announcements made by press conferences or conference calls that interested members of the public may attend.
  - Posting info to a CO's website will not, by itself, be likely to satisfy the generally disclosed requirement.

3.6 Unintentional Disclosure
- If a CO makes unintentional disclosure, it must take immediate steps to ensure that a full public announcement is made.

4.1 Materiality Standard
- This is another repeat of the *SA*. Materiality is a two part test. A fact is material when:
  - It significantly affects the market price or value of a security, or
  - It would reasonably be expected to have a significant effect on the market price or value of the sec

4.2 Materiality Determinations
- The materiality of a particular event or piece of information may vary between companies according to their size, the nature of their operations and many other factors, such as market conditions

461.5 Disclosure Requirements and Liability

Examples of potentially material info	
Changes in Corporate Structure	• Change in share ownership or control • Major reorganizations, amalgamations, mergers • Take-over bids, issuer bids, insider bids
Changes in Capital Structure	• Public or private sale of additional securities • Planned repurchases or redemptions of securities • Share consolidations or splits • Changes in dividend policies • Proxy fight • Changes of rights of security holders.
Changes in Financial Results	• Significant increase or decrease in near-term earning prospects • Unexpected changes in financial results
Changes in Business and Operation	• Any developments in resources, tech, products, or markets • A significant change in capital investment plans or corporate objectives • Labour disputes • Capital investment and significant new contracts. • Discoveries of resources • Significant legal proceedings • BOD or executive management changes
Acquisition and Disposition	• Significant acquisitions or disposition of assets, property or joint venture interests • Acquisitions of other CO
Changes in Credit Arrangement	• Borrowing or lending money. • Mortgaging on company's assets • Changes in rating agency decisions

Defensive Tactics

Motivations behind a take-over bid may include:
- Creation of synergies: abilities to extract values through cost-savings that would not have been possible without the merger
- Ability to increase market share and have more control of the market
- Tax reasons.
- Belief that the other CO is inefficient and its practices can be improved.
- Belief that the other CO is undervalued and would make a very good investment.
- Consolidation of operations.

Horizontal Merger: An acquisition of a CO by it's competitor in the same line of business.
Vertical Merger: A supplier buying a customer or a customer buying a supplier.
Conglomerate Merger: An acquisition of a CO by another CO that wants to expand into a new business.

- Defensive tactics are undertaken by the target Board in response to a hostile take-over bid.
- The most common strategies are outlined below.

White Knight Defence: A friendly acquisition of a CO that is a subject to a hostile bid. The intention of the acquisition is to circumvent the take-over of the object of interest by a third, unfriendly entity, which is perceived to be less favorable. The knight might defeat the undesirable entity by offering a higher and more enticing bid, or strike a favorable deal with the management of the object of acquisition.
White Squire Defence: A defense similar to a white knight, except that it only exercises a significant minority stake, as opposed to a majority stake. A white squire doesn't have the intention, but rather serves as a figurehead in defense of a hostile takeover. The white squire may often also get special voting rights for their equity stake.
Crown Jewels Defence: A strategy in which the target CO sells off its most attractive assets to a friendly third party or spin off the valuable assets in a separate entity. Consequently, the unfriendly bidder is less attracted to the CO assets. Other effects include dilution of holdings of the acquirer, making the take-over uneconomical to third parties, and adverse influence of current share prices.
Standstill Agreement: An strategy where the hostile bidder agrees to limit its holdings of a target CO for a period of time, in exchange for confidential information. In many cases, the target CO is willing to purchase the potential raider's shares at a premium price, thereby enacting a standstill or eliminating any takeover chance. By establishing this provision with the prospective acquirer, the target firm will have more time to build up other takeover defenses.
Poison Pills (Shareholder Rights Plans): The target CO issues rights to existing SHs to acquire a large number of new securities, usually common or preferred shares. The new rights typically allow holders (other than a bidder) to convert the right into a large number of common shares if anyone acquires more than a set amount of the target's stock (typically 15%). This dilutes the percentage of the target owned by the bidder, and makes it more expensive to acquire control of the target.
- Nobody would knowingly trigger a SRP, as it causes massive dilution of shares and ownership
- In Canada, the legality for SRPs has never been fully established, and many lawyers think that these are unlawful.

To induce a bid or a support agreement from a white knight, a CO has a number of methods of making itself a more lucrative.

Break Fee: A fee the offeree pays to a new offeror as an inducement to step in and prevent a takeover by someone else. The standard practice is about 2-4% of the offer's size. Often, this will cover costs incurred by bidder (legal fees, admin costs, etc).
Asset Option: An agreement for bidder to acquire part of target CO's assets.
Lock-Up Agreement: An agreement whereby a offeree SH grants an option to the offeror to purchase his shares, thus ensuring a foothold for the offeror. Open lock-up allows offeree to withdraw if a better offer comes along. Closed does not.
No-shop Provision: An agreement, which, once signed, prevents the Board from looking for a competing bid. It could also prohibit the Board from accepting any other offers, but this is most likely going to be a violation of their fiduciary duty.
Support Agreement: An instrument of a friendly takeover bid, whereby the bidder commits to moving forward with the transaction at an agreed price and quantity, and the Board of the target CO agrees to recommend that SHs tender into the bid, and that the target CO will run in the normal course of business until the completion of the bid. In addition, the Board will usually sign a no-shop provision, but will reserve the right to respond to unsolicited inquiries and to recommend a competing transaction if it amounts to a "superior proposal" for the SHs. There is a potential issue of fettering to be decided on circumstances, and can be solved with a "fiduciary out" clause.

NI 62-202: Take-over Bid Defensive Tactics

This is a national policy guideline that describes the SecCom position on defensive tactics.

- Management of the target CO may take one or more of the following actions in response to a bid that it opposes:
  - Attempt to persuade SHs to reject the offer
  - Take action to maximize the return to SHs including soliciting a higher offer from a third party
  - Take other defensive measures to defeat the bid.
- The primary objective of TOB legislation is the protection of the bona fide interests of the SHs of the target CO.
  - The secondary objective is to provide a regulatory framework where TOBs may proceed in an open and even-handed environment.
- It is not a good idea to have specific code of conduct that will apply to all cases, but specific cases may be scrutinized, if:
  - There is an issuance of securities representing a significant percentage of outstanding securities of target CO.
  - There is a sale or acquisition, or agreeing to such, of assets of material amount
  - There is a K or corporate action that deviates from normal course of business
- The policy approach is that unrestricted TOB auctions yield more favourable results.
- Regulators are prepared to override take-over defenses, especially SRPs in appropriate cases.

Canadian Cases

Teck Corp v. Millar [1973] BC SC

If the directors reasonably consider that a take-over bid will cause substantive damage to the CO's interest, they can rely on all of their powers to prevent it.

Facts: Millar was the President of Afton who needed capital but was having trouble raising money to run the CO. Suddenly drilling results improved for Afton, but still not enough to raise enough money to develop their properties. Millar turned to a larger CO called Placer, and signed a K whereby Placer would provide funds through their subsidiary Canex, on the condition that Millar would issue shares in Afton to Canex. While this was going on, Teck Corp began a takeover bid for Afton, offering higher price to its SHs than Placer was. Millar and the Board were not happy with Teck and wanted to make permanent deal with Canex. To facilitate this they revised the original K with Placer so that Canex would get a larger share of Afton. PL CO claimed that Millar and fellow directors committed breach of fiduciary duty by agreeing to issue shares to Canex because the motivation for doing so was not to get money from Canex, it was mainly to block success of PL CO's bid and keep their jobs.

Issue: Was the purpose of issuance to benefit the CO or to keep their jobs?

Discussion:

- The basic test is whether directors action is bona fide in best interests of CO.
- Directors are entitled to consider reputation, experience, and policies of anyone seeking to take over control.
- If they decide on reasonable grounds a take-over will cause substantial damage to the CO's interest, they are entitled to use their powers to protect company.
- The Australian case of *Mills v. Mills* was the first to developed the proper purpose test, where the first job for the judge is to to isolate what court thinks was primary purpose for issuance of shares.
- The court looks at the facts finds that Millar issued shares to get best financing to develop the claims, not to defeat PL CO's bid. This is a proper purpose for the issuance of shares.
- Even if the primary purpose of issuance to defeat take-over there is a way out.
- As long as there are reasonable grounds that directors can point to justify taking measures to defeat takeover bid, even issue of shares for such purpose may not be a breach of fiduciary duty.
- In US, once PL shows that the primary purpose is to defeat take-over, the onus shifts to directors to show it was in best interest of CO to defeat it.

Ruling: No improper purpose.

Re Olympia & York Enterprises and Hiram Walker resources [1986] ON HC

If the Board acts in good faith, or what they believed on reasonable good faith, for the best interest of the company, then the fiduciary duty is not breached.

Facts: OLY was a private investment CO, with about 14% of HW, which was a large conglomerate that held three main branches: the spirits business, a gas business, and a natural resource business which owned Home Oil. The largest block of shares of HW (15%) was owned by IPL, which was a pipeline CO. HW became the target of a TOB by Gulf, which was mostly controlled by OLY, at $35 per share. Gulf entered into a lock up with IPL and OLY, giving them the chance to have majority control of HW. In the response to this, HW sold its spirits branch to Allied, which was a French spirits conglomerate. The money from the sale was put into a new CO called Fingas, which was essentially a shell CO. Its purpose was to buy a controlling packet of shares in HW at $40 and prevent the Gulf takeover. Of course, HW could have taken the money themselves, and done a self-tender, but doing it through a proxy saved $300m in taxes. HW did not officially control Fingas: only 49% of it, the rest being held by Allied, and past directors of HW. The hostile group filed the action.
Issue: Was the use of corporate assets to prevent the take-over improper as pursuing self interest of the Board? Was Fingas a sham to avoid the CBCA?
Discussion:

- Trial court dismissed the proceedings because:
  - Directors are not in breach of their fiduciary duty if they act in good faith in what they reasonably believe to be the interest of the CO (*Teck Corp*). If they benefit as a result, then oh well, shit happens.
    - The Board has relied on independent advise from financial firms.
    - They realized that the $35 per share was a low bid, and instead made a bid at $40.
    - At the same time, the Allied offer was very lucrative, and financial advisers suggested that it be accepted.
    - So in this case the HW Board acted in best interest of the CO.
  - It is a duty of the Board to make sure that SHs get most benefit from all transactions.
    - Saving $300m in taxes falls into this category.
    - HW has only 49% of Fingas, and is not within a literal reading of the CBCA that governs subsidiary self-tender.
- High Court Decision
  - For some reason the HC assumes without deciding that the actions of HW in creating Fingas were contrary to *CBCA*.
  - Based on this, they find that the Allied sale was entrenched in the illegal creation of Fingas, which was a non-severable component of the transaction.
  - In creating Fingas, HW Board adopted a highly innovative device in the apparent belief that it was legitimate.
  - Breach of statute can amount to illegality that justifies a K to be set aside (*Lightfoot v Tenant)*, but here, HW Board acted on advice and in the best interest of the CO, thus there is no deliberate flouting of positive law.
  - But the illegality is still to be decided at trial.

Ruling: Appeal dismissed.

Pente Investment Management v. Schneider Co [1988] ON CA

So long as the Committee acts reasonably and its recommendations are accepted by the Board, the directors will be found to have fulfilled their duty

Facts: Schneider was a sausage giant, controlled by the members of the Family who had 75% of voting shares. They also had 17% of the non-voting ones. Maple Leaf was a challenger to Schneider's sausage monopoly, which made a bid at 19$ per share. Th Schneider Board established a Special Committee, made up of independent non-Family directors. In response, ML increased the bid to $22. The Family indicated that it had non-financial criteria for accepting of rejecting a bid, including continuity of employment for employees The Family found a white knight Smithfield Foods, who made an offer of $25 per share. To do so, the Board had to approve of the Family entering into a lock-up agreement. After the Family agreed to Smithfield's offer, ML offered $29 and brought an action seeking to have the court invalidate the Smithfield agreement on the ground that the actions of the directors and the family unfairly disregarded the interests of non-family SHs and unfairly prejudiced them. ML argued that its offer triggered the coattail provision in Schneider's articles notwithstanding that it offered the same premium to the non-voting SHs as to the common voting SHs. Trial judge found that the Special Committee and the directors acted honestly and in good faith with a view to the best interests of Schneider and that the coattail provisions were not triggered as ML intended to make identical offers for the voting and non-voting shares and did not disclose that its offer was exclusionary in its take-over bid circulars. ML appealed.
Issue: Was the decision of the Committee and the Directors prudent?
Discussion:

- The Directors on the Special Committee acted in good faith and were entitled to deference.

- The Committee's decision was informed as it was aware that ML could better any existing offers.
- When tax considerations were factored in, the ML offer was not more advantageous than the Smithfield's.
- The involvement of senior management in the negotiations with the potential bidders did not create a conflict of interest.
- The appointment of the Special Committee was in the interests of all SHs to ensure that there were alternatives to an unsolicited takeover offer to obtain the best transaction available in the circumstances.
- There was no obligation to give ML an opportunity to make a third bid as there was no reasonable expectation on the part of non-family SHs that an auction would be held after receiving the last Smithfield bid.
- As it was widely known that a change of control was considered and few rival bids were forthcoming, the lock-up was in the interests of the non-family SHs.
- The purpose of adopting a coattail provision was to discourage exclusionary offers.
    - Here it appeared to the SHs that the offers were the same and ML knew its offers would be perceived that way.
    - The interpretation of the offers by the trial judge was consistent with the way a reasonably prudent business person would construe the offer. His conclusions were commercially sound.

Ruling: Appeal dismissed.

CW Shareholdings Inc v. WIC Western Communications [1998] ON PC

No one has ever described a takeover battle as a teaparty. Validity of break fees and asset options.

Facts: WIC was a telecom CO with two classes of shares: voting non-publicly traded Class A, and non-voting TSX-traded Class B. Class B had a coattail that gave it voting power in case of a TOB. CanWest, through a subsidiary CW Shareholdings, was holding 38% of Class B and 0.4% of Class A shares. This made it the largest holder of WIC equity. Shaw Communications was its rival, recently granted 49% of WIC's Class A shares. CW made an unsolicited bid for all of A and B shares at $39 per share. The bid was rejected by the WIC Board, and they actively sought to find a white knight, establishing a Special Committee. Such materialized in the form of Shaw, but only after WIC sweeten up the deal a little. Shaw was offered a $30m break fee in case that their bid fails, and an option to purchase WIC's radio assets at the price of $130m, regardless of the success of the bid. With this in mind, they made a bid for all of Class B shares, at the price of $43 per share. CW acted like a little bitch and filed for an oppression remedy, claiming that WIC's Board was in violation of its fiduciary duty, and seeking to have the "inducements" set aside.

Issue: Are the inducements legit?

Discussion:

- CW, being a major equity holder has a claim under oppression remedy. This is different from some cases in the past where a bogus claim was made by bitter bidders.
- The duty of the directors is described by the *CBCA,* and here the court also makes a reference to the "shifting duty" as described in *Revlon*.
    - The directors must make a decision and exercise their judgement in an informed and independent fashion, after a reasonable analysis of the situation and acting on a rational basis with a reasonable grounds for believing that their actions will promote and maximize SH value.
    - Due deference is given to business judgement.
- Special Committee is the proper way for directors to address this duty and to prevent conflict of interest.
    - In this case, the circumstances were questionable, since among Committee members were directors of WIC, and its CEO. But, on evidence available, it was not significant enough to warrant a breach, despite the apparent conflict.
- Break fees are a valid and common inducement, that will be acceptable if:
    - The Special Committee finds them necessary in order to induce a competing bid to be put forward.
    - This bid will give better value to SHs
    - The break fee is not obscene and represents a reasonable commercial balance between its role as a potential auction inhibitor and stimulator.
- Asset options are also legit, albeit less common, when:
    - It satisfies the aforementioned balance between stimulator and inhibitor,
    - The price for the asset is within the range of reasonable value.
    - The induced bid is of sufficiently higher value to justify the offer.
- Such measures are allowed, as long as they stimulate an auction, not stifle or end it.
- In this case, the inducements were proper.
    - The break fee was a small amount in comparison to the TOB
    - The radio assets were fairly low key, representing a tiny percentage of WIC's income model, and were fairly valued.

Ruling: CW has to stop being such a crybaby.

In the Matter of Sears Canada and Hawkeye Capital Management [2006] ON SecCom

Disclosure obligations are a contextual, and require the exercise of judgment.

Facts: Two application were filed in relation to an offer by Sears Holdings to acquire all of the outstanding common shares of Sears Canada. Sears H held 54% of outstanding common shares of Sears, so, the transaction is an insider bid. Sears H informed the SH of Sears of its intention to take Sears private, thus having to complete a second step subsequent acquisition transaction (SAT), for which "majority of the minority" approval would be required. The offer was announced on Dec. 5, 2005, formally commenced on Feb. 9, 2006, and expired on August 31, 2006. By April 6, 2006, Sears H announced that it had entered into enough support agreements with banks to ensure that a majority of the minority would approve the "going private" transaction. A special committee to the old board of Sears felt the bid was undervalued and a new board was brought in May 2006 when Sears H had around 70% control. Before the transaction Pershing, a minority SH entered into some deals with Vornado, which eventually tendered into the bid. The big issue is the conduct of Sears H regarding a number of support agreements corresponding to a bid revision and extension announcement and a deal with Vornado to increase the share price midway through the bid.

Issue: Did Sears H meet disclosure obligations? Was its conduct coercive? Did Pershing and Vorando fail to disclose beneficial ownership?

Discussion:

- Pershing and Vornado had a deal to cooperate in acquiring Sears Canada shares and pay finders fees.
  - V then double-crossed P by tendering to Sears H without P's knowledge, so they stopped working jointly.
  - Because of this, they were not in violation of early warning provisions to disclose their 10% holding of shares
  - Formal agreements are helpful in the finding of "jointly or in concert," and the question is one of fact.
- P also "parked" 6.9m shares in 2005 and 2006 with SunTrust for tax purposes and not to antagonize an business relationship with Sears H. Sears H alleged that P parked the shares to exclude them from voting in minority approval.
  - SecCom found that P had no knowledge of who bought the 2005 shares and could not have exercised any control over their votes remotely and no evidence to support the assertion that the shares from the 2006 swap would be somehow spun back or controlled by P.
  - The conduct was not abusive to capital markets, but a "normal" transaction and public interest was not engaged.
- It was alleged that BNS and Scotia Capital were joint actors with Sears H and BNS and Scotia went beyond being merely financial advisors to ensure the success of the deal through an understanding, commitment or agreement.
  - Merely being the dealer of financial advice does not automatically warrant joint actor status.
  - Soliciting dealers can ID owners of shares and ascertain their willingness to bid.
  - The Support Agreements BNS and Scotia signed with Sears H were based on their interest in maximizing returns for Sears shares and gaining favourable tax consequences.
  - So their interest was independent of Sears H's interest in the minority vote and they did not participate in any way in assisting Sears H to plan, promote or structure their offer.
- Did Sears H comply with its disclosure obligations?
  - Sears H should have disclosed parties to Support Agreements even if the agreements would not take effect until a majority of the minority would approve of the SAT because they had stated in a pervious release that no agreements whatsoever existed. This was misleading the marketplace.
  - Sears H also failed to disclose a 3 month price protection deal with Natcan when they announced a lock-up with Natcan. Such information may well have affected share price.
  - Insiders need to ensure that minority interests are treated fairly.
- Unnecessary to answer if the conduct of Sears H in connection with its offer coercive or abusive.
  - But the absence of a "minimum tender condition" is not coercive.
  - An undervalued bid is not coercive or abusive if the SH have access to independent valuation.
- As a whole the conduct of Sears H was abusive and coercive to markets as a whole and the minority, however, the transaction as a whole is not abusive enough to warrant a public interest cease trade order.

Ruling: Compliance order against Sears H to disclose.

BCE Inc. v. 1976 Debentureholders [2008] SCC

Under a Statutory Plan of Arrangements, the court has to consider the interest of all parties involved.

Facts: Ontario Teachers Pension Plan Board led a consortium of purchasers, which made an $52b offer to for a leveraged purchase of all shares of BCE, which is a large telecom CO. Under the structure of the offer, Bell would assume a $30b portion of liability for the debt. Bell is a wholly owned subsidiary of BCE, but the two share a common set of directors and some senior officers. The Board deiced that the offer would be in the best interest of BCE and its SHs. In evaluating the offer, the Board consulted several reputable financial advisors. The offer was approved by 97%of BCE's SHs. The offer is

opposed by a group of financial institutions that hold $7.2b worth of debentures of Bell, and who argue that the purchase devaluated their debentures by 20%, which for 30 years have been seen as secure investments. They pursued an action on the grounds oppression (s.241 of CBCA) and breach of fiduciary duty because the arrangement was not fair and reasonable. Under s.192 CBCA there is a need for court approval to change CO's structure. QBSC approved the transaction, but QBCA overruled that decision.
Issue: Should the interest of debentureholders be considered in a plan of arrangement?
Discussion:
- This is relevant to the Statutory Plan of Arrangements, and the duty of directors to various interests.
- The content of the directors' fiduciary duty was affected by the various interests at stake in the context of the auction process and by the fact that they might have to approve transactions that were in the best interests of the CO but which benefited some groups at the expense of others.
- The directors considered the interests of debentureholders, and concluded that while the contractual terms of the debentures would be honoured, no further commitments could be made.
- Under a Statutory Plan of Arrangements, the court has to consider the interest of all parties involved.
- Although in some circumstances interests that are not strictly legal can be considered, the debentureholders did not constitute an affected class under s. 192 since only their economic interests were affected by the proposed transaction, not their legal rights, and since they did not fall within an exceptional situation where non-legal interests should be considered.

Ruling: Appeals allowed and cross-appeals dismissed.

American Cases

Unocal Co. v. Mesa Petroleum Co. [1985] DEL SC

If the Board is disinterested and act in good faith, its decision in the absence of abuse of discretion will be upheld by the business judgment rule.

Facts: Mesa was the owner of 13% of Unocal, which was a large gas and oil CO. Mesa, was run by T. Boone Pickins Jr. - a notorious raider and a greenmailer who launched a two tier takeover bid: the first tier was a cash offering for 37% of Unocal's shares at $54 per share, the second tier was an exchange offer to trade the rest of Unocal's shares for junk bonds allegedly worth $54 per package. The junk bonds would actually be the repackaging of the debt that Mesa incurred in financing the front tier of the takeover, which would severely fuck up Unocal's leveraging. Unocal's Board consulted with independent financial advisors, who said that the offer is shit, ignores the true value (which was closer to $60 per share), and would really screw over the SHs who would get stuck with the second tier junk bonds of their own debt. Based on this advice, the Board unanimously decided to reject the offer, and to counter it with a self-tender buyback in case that it still went through. In such case, they decided to use CO's money to make an offer for the 49% of the outstanding shares, at $72 per share, and make the offer unavailable to Mesa. Mesa sued for violation of fiduciary duty.
Issue: Did the Unocal Board have the power and duty to oppose a takeover, and if yes, are their actions protected by business judgement rule?
Discussion:
- The Board's power derives from its fundamental duty to protect the corporate enterprise and the interest of the SHs.
- In situations where there is a threat to the control of the Board, and the a CO uses its funds to remove a this threat, there is an inherent danger of conflict.
- In such cases, directors must show that they have reasonably believed that the threat was a threat to the corporate policy and effectiveness.
- They satisfy the burned by showing good faith and a reasonable investigation.
  - Such proof is also increased if the outside directors (who have no conflict of interest) vote in favour.
- Hence business judgement rule is given deference
- But it must be proportionate to the threat perceived.
- In this case, the two tier offer was coercive, designed to scare the SHs to stampede into the first tear, lest they are stuck with the garbage junk bonds.
- This, combined with the low offer price, made for a reasonable threat that was perceived by the Board.
- It's objective then was to defeat the inadequate Mesa offer, or if it succeeded, to provide the 49% of SHs with cash instead of junk.
- Such efforts would have been thwarted if Mesa was included in the self-tender.
- Furthermore, principle of selective repurchases are not unauthorized.
- So there is nothing wrong here

Ruling: T. Boone fails.

Greenmail: A CO making partial bid at a high enough price with expectation that target CO would offer to buy the bidder's shares at a higher price to prevent the take-over. In Canada there is no greenmail because issuer bids have to be made generally, and an issuer cannot selectively bid to specific SHs.
Bust-Up Take-over: A leveraged take-over, where the bidder aims to break up and sell off parts the target CO after the acquisition to finance the debts incurred in the purchase.
Front-Loaded Bid: A two tier bid where the second stage is such a shitty deal, that SHs will be scared to get stuck tendering their shares into it, and will stampede to tender into the first stage, even if the first stage itself is not as appealing. This is usually seen as coercive.

Intermediate Standard Test: *Unocal v. Mesa* uses an intermediate standard between fairness and business judgment. Paterson thinks that this is the best one around. It is a two part test:
1. Identify whether exercise of power represents conflict of directors interest and that of CO;
2. Once conflict is proven, next stage shifts the onus to directors to give reasonable grounds that what they did was in CO's best interest.

Revlon Inc v. MacAndrews & Forbes Holding [1986] DEL SC

Where the breakup of the company is inevitable, the duty of the directors changes to getting the highest price, and in such situations, White Knight favoritism to the total exclusion of a hostile bidder, is inappropriate, especially where the bidders make similar offers. This could be the law in Canada

Facts: MacAndrews & Forbes were the controlling holder of Panty Pride, which is the chief PL in the case. PP was a small highly leveraged firm that had a history of bust up take-overs. They made a hostile bid at $45, which Revlon, based on independent advise found to be grossly inadequate. They responded with a buy back of some shares, in exchange for debenture Notes, which was a hot seller, with 87% of outstanding shares tendered into it. Revlon also created a SRP that allowed SHs to sell their shares to Revlon at a premium in the event of a 20% acquisition by an outsider. PP then raised the offer to $53 per share on all of the outstanding shares. Faced with such determination, Revlon found a White Knight in the shape of Forstmann Group, who made an offer at $56 per share, and agreed to take on the debts of Revlon, subject to the waiver of the covenants of Notes and SRPs. On this news, the value of Notes began to decrease, and there were talks of lawsuits by the debentureholders. Then PP announced that it would top any offer that Forstmann would make. Still Revlon favoured Forstmann, making it privy to some secret data. The final offer from Forstmann was accepted unanimously. It was $57 per share, with an asset option (in US called a lock-up option) for some of Revlon's assets, a no-shop provision, and an agreement to support the value of the Notes to avoid litigation. At this moments, the standing PP offer was $56.50, with no conditions.
Issue: Did directors of Revlon act in breach of fiduciary duty in accepting the Forstmann's offer?
Discussion:
- In the end, the two offers were very similar, as both were conditional on financing.
- When the Board implements anti-takeover measures, there is always a suspicion of self preservation and conflict of interest.
- SRP were within the scope of the power of the Board, especially since at the time Revlon was faced with a crappy offer of $45 per share. So there is no issue here.
- The buy-back was also alright at the time.
- However, things changed that PP raised the bid to $53 per share. This meant that they were not dicking around and were intent on getting the CO.
- At this point the break-up of the CO became inevitable and the duty of the Board changed from preservation of the CO to the maximization of the CO's value for the sale, to provide most cash for the SHs.
- In a sense, their role changed from defenders of the CO to auctioneers.
- One of the big concerns that the Board dealt with was taking care of the troubled debentureholders. This was wrong:
  - Their primary responsibility was to SHs. Debentureholders required no further protection at this point.
  - Appeasing the debentureholders was a way to avoid litigation for the Board.
  - In the context of the shifted duty of the Board as auctioneers of the CO, such concern was inappropriate and self-interested.
- Using this concern as a lure, they were tempted into an asset option with Forstmann.
  - While asset options are usually alright, they may be harmful where they effectively preclude bidders from competing with the optionee bidder.
  - In this case, this is what happened here. The option had a destructive effect on the auction process.
  - It was also undervalued given the assets being sold.
- Ditto for the no-shop provision. It is not allowed when the Board's duty shifts to getting the highest price.

- All in all, given two bids that were fairly close, the Board acted in self interest and in breach of their fiduciary duty, by heavily preferring one bidder to the other.
- Based on this, the court grants injunction.

Ruling: Panty Pride wins!

Shareholder Rights Plans

- Sec Com is influenced by the specific circumstances, and seems to tailor the decision to the facts of the case.
- This is also helped by the fact that the value of precedence at SecCom not the same as in normal Court.
- SecCom at first took a broad interpretation of whether SRPs are valid, but over the last two decades the the interpretation has gotten narrower. Now, it seems to just depend on who's on the panel you appear in front of.

In the Matter of Canadian Jorex ltd. [1992] ON SecCom

If the SRP is against public interest as declared by NI 62-202 it will be struck down

Facts: Mannville Oil & Gas announced its intention to make a take-over bid for Jorex, offering 0.85 of a share of Mannville for each share of Jorex tendered. Jorex Board recommended rejecting the bid. The Board also decided to adopt a SRP. The adoption of the SRP did not result in any enhancement of the Mannville bid, but Canadian Trans-Arctic made a cash bid, at $2.70 a share, for 55% of the shares of Jorex. The Board recommended acceptance, and waived the SRP conditions to allow for the Trans-Arctic bid. Mannville complained that SRP was contrary to the public interest and should be stopped.

Issue: Is the SRP contrary to the public interest?

Discussion:

- No Canadian court or securities regulator has yet had to rule on the overall validity of SRPs. This is not the issue here. The issue here is situation specific.
- In this case the SRP is against public interest.
  - It is clear that the Mannville bid could not proceed unless the effect of the SRP was first removed.
  - Maintaining the SRP in effect against Mannville was not going to result in anyone else joining in the Jorex auction.
  - Maintaining of the pill wasn't going to get Manville to raise it's own bid.
- The primary concern in take-over bid regulation is whether the defence tactics are likely to deny or severely limit the ability of the SHs to respond to a take-over bid or a competing bid.
- In this case, the SRP clearly prevented a valid bidder from entering the auction, and deprived the SHs of choice.
- Because of this the SRP is voided.

Ruling: SRP struck down.

Re Royal Host Estate Investment Trust [1999] BC SecCom

Every ruling on SRPs will be based on the facts of each case, to decide if it is contrary to public interest

Facts: RH and Canadian Hotel Income Properties were both unincorporated, close-end REITs that held hotel properties all over Canada. There was talk of the two merging, but this was rejected. At a alter point, CHIP, aware of possible takeover bids, considered putting in a SRP but this was rejected, based on the belief that most SHs would be opposed to this. But when RH announced their intention to commence a TOB, CHIP implemented an SRP that allowed rights holder to purchase more units at a significant discount, unless if the TOB is a "permitted bid." RH's bid complied with all the terms but one that would make it a "permitted bid". After receiving the RH's bid, CHIP's Committee focused on attracting other offers to maximize the value for the SHs. They opened data rooms in major cities, and sent out info packages to many potential buyers. They also recommended that SHs reject the RH bid, as coercive, undervalued, and overall foul. As the time for RH's bid was running out, RH applied to SecCom to have the SRP set aside. At the hearing, witnesses testified that there was a reasonable possibility that a superior competing bid will arrive, but more time was required that was allowed by the RH bid, due to the complexities of REITs.

Issue: Should the SRP be set aside to allow for the RH bid to take place?

Discussion:

- SRP proceedings are fact-specific, keeping in mind the following considerations. See box below.
- Given the facts above, it would not be in the public interest to terminate the SRP.
- But if RH was to choose to extent the bid, the SRP will cease to operate after a period of time.
- This is because the point of the bid was to allow other offers to come in, not to stop the TOB completely.

Ruling: SRP kept in place temporarily.

Circumstances to Consider with SRPs:

- Whether SH approval of SRP was obtained.
  - If SRP does not have SH approval, it generally will be suspect; however, SH approval itself will not establish that a SRP is in the best interest of SHs (*Cara Operations*).
- When the plan was adopted.
  - If SRP is not put in place before a particular bid becomes evident then it is very likely that it is directed at particular bid (*Cara Operations*).
- Whether there is broad SH support for continued operation of the plan.
- The size and complexity of target CO.
- Other defensive tactics, if any, have been implemented by the target CO. If such are present, then the SRP is clearly an attempt to frustrate the specific bid.
- Steps taken by CO to find a better bid.
- Likelihood that, if given further time, the target CO will be able to find a better bid.
- Number of potential, viable offers.
- Nature of the bid, and whether it is coercive or unfair.
- Length of time since bid was announced.
  - Regulators pressured by institutional SHs have agreed to waive 35 day requirement and say it should be ~45-55 days or longer.
- Likelihood that the bid will not be extended if the SRP is not terminated.

In the Matter of Inco Ltd. and Teck Cominco Ltd. [2006] ON Sec Com

Where it is in public interest to do so, the Sec Com will lift an SRR

Facts: This is the extended fact pattern with the following case. Inco and Phelps Dodge were engaged in a friendly bid over Falconbridge. Both Inco and Falconbridge has in place typical SRPs which would severely dilute the share positions in case if a non-permitted bid for more than 20% of the shares was successful. Inco also made an agreement with Phelps Dodge that in case that their combined bid for Falconbridge would fail, then Inco would amalgamate with a wholly owned subsidiary of Dodge, thus becoming its subsidiary. Everything was fine and dandy, but at roughly the same time Xstrata made an unsolicited bid for Falconbridge, and Teck Cominco made an unsolicited bid for Inco. Falconbridge bid is discussed in the next case. Teck's bid was one step shy of a permitted bid - in that it failed one minor detail, because of US security law concerns. After consultation with SEC, Teck was allowed to comply with the last requirement, but Inco claimed that to be permitted, the bid would have to comply with the conditions from the get-go. After subsequent negotiations, Teck and Inco agreed to lift the SRP, but only against the Teck bid. They submitted this to ON Sec Com.

Issue: Should the SRP be lifted as proposed?

Discussion:

- The draft agreement lifted the SRP only against Teck, because:
  - In TOB hearing the SecCom can only deal with the parties before it, not potential third parties.
  - The SRP was needed to protect Inco from potential future coercive bids.
- ON Sec Com disagreed.
  - The point of TOB Regulations is to protect bona fide interest of SHs of the target CO.
  - Unrestricted auctions provide the most desirable results for the public interest.
- At this stage in the contest for control of Inco, market forces and SHs acting in their own best interest will decide the outcome.

Ruling: The SRP should be lifted against all bids.

In the Matter of Falconbridge Ltd. [2006] ON SecCom

SRP will be maintained where it protects SHs from a potential risk of being fucked over.

Facts: The same fact pattern as above, but dealing with the Falconbridge SRP. In 2005 Xstrata acquired a 19% position in FL. After this FL entered into preliminary negotiations with Inco and implemented an SRP, triggered by any non-permitted bid for more than 20% of the CO. Inco made a formal offer, subject to several conditions, but permitted under the SRP, and the two COs entered into a support agreement. The offer was extended three times, pending financing and regulatory approval. At this point, the SRP expired and was renewed. In May 2006, XS made a formal all cash offer that was conditional on the tender by the majority of SHs (majority of minority). FL dismissed this as highly conditional, and not permitted under SRP. FL was afraid that XS will close the offer once it acquires a controlling block of shares, and would exclude all other SHs. FL was prepared to waive the SRP if XS would promise that if it takes up any shares under its offer, it

would keep the offer open to allow all other SHs to tender. XS refused. At the same time, Inco and Dodge Phelps gave a renewed, improved offer. XS applied to have the SRP lifted.
Issue: Should the SRP be cease traded?
Discussion:
- SecCom referred to *Lac Minerals* and *Royal Host* cases for the authority on SRP's legality, and the list of factors to consider.
- In determining an SRP, a balance has to be struck between allowing directors to protect the CO's interest, and allowing SHs to make a choice by tendering their shares into an offer.
- It noted that all SRP cases are very fact specific.
- The relevant factors here are:
  - XS is the largest SH of FL.
  - FL was concerned about XS's conditional offer and the potential of abusive behaviour.
  - FL did not seek SH approval of the SRP
    - If SRP does not have SH approval, then it will be generally suspect as not being in the best interest of SHs
  - FL has been "in play" for almost a year.
    - The longer the period, the higher the onus of those defending the SRP.
  - The SRP was clearly a defensive reaction after the initial XS acquisition.
  - FL was not actively seeking better offers.
- But the XS bid, being highly conditional, was potentially coercive, and there was a risk that a significant takeup by XS would cause it to waive its minimum condition, and end the auction early, screwing over the FL SHs that did not tender.
- Thus it would be in the public interest to keep the SRP in place for a while.
- So it is kept in place until XS fulfills its "majority of minority" condition, or the bid expires. Either of these dates would allow secure knowledge that XS will not fuck over the FL SHs.
- Secondary issue was whether XS should be prohibited from acquiring up to 5% of FL shares through the "creep up" provision permitted by s.94(3) of *SA*.
  - s.94(2) prohibits an offeror from acquiring target CO shares during a TOB.
  - s.94(3) is an exemption to (2) which allows bidder to purchase less than 5% of target CO under conditions.
- It is in public interest to order, pursuant to s.127(3), that the 5% exemption not apply to XS, as it would give XS the ability to end the TOB auction prematurely by giving them a blocking position in FL.

Ruling: Order made.

Neo Material Technologies inc. and Pala Investments [2009] ON SecCom
SRPs may be adopted to safeguard the long-term interest of SH, consistent with reasonable business judgements.

Facts: NEO had an initial SRP written in the Articles, but in the face of a bid from Pala, NEO adopted a second SRP amending the minimum tender requirement from 50% to 100% to "stop creeping ownership plays." This was approved by a majority SH vote, and SHs provided with adequate information and were not coerced or unduly pressured into their decision. NEO's Board refused to put a Pala proposal to SH vote removing the SRP based on alleged timing violations. Pala asked SecCom to set aside the SRP.
Issue: Under what circumstances should a commission cease a trade for a SRP based on public interest?
Discussion:
- The duty here is to the CO in general, not to the SHs, because it is not clear that the fall of the CO is inevitable. (Based on *BCE*: best interest of the CO is more than short-term share value for the SHs.
- It is an error to focus on just investor protection; public interest involved a consideration of the public confidence in the capital markets.
- The second SRP was a direct response to Pala's offer.
- 81% of SH voted in favour and the proxy turnout was among the highest in years and the SH were properly informed by the Director's Circular setting out cogent financial reasons for preventing the bid: liquidity issues, undervaluation, the absence of a control premium, etc.
- To interfere where no legislation prohibits the action, the said action must be abusive, and must show a broader impact on capital markets and their operation.
- The Royal Host Factors are important, however, SRPs are very fact and case-by-case specific. SH approval is cogent, however, does not necessarily impeded a public interest ruling and depends on freedom from coercion and adequate information.
- SRPs may be adopted to safeguard the long-term interest of SH, consistent with reasonable business judgements.
- The decision of the board to adopt the second SRP and not to seek an action was within a reasonable range of alternatives and consistent with the business judgment rule and their fiduciary duty to the corporation.

Ruling: SRP stays in place.

Restricted Voting Shares

Since the holders of non-voting shares do not have the control of the CO that the voting SHs do, there is a danger that their interest will be ignored in a take-over situation. Because of this, TSX has developed a set of rules to protect them.

TSX Policy Manual

- TSX is a self-regulatory organization, and the Manual is a detailed compendium of TSX regulation.
- Some of the definitions relevant to the section below are:

Residual Equity Security: Security that has a residual right to share in the earnings of a listed issuer and its assets upon liquidation. This covers the broad range os shares: voting and non-voting.
Common Security: A fully franchised security with an unrestricted right to vote.
Restricted Security: All Residual Equity Securities that are not Common Securities. There are four kinds of these:
- **Non-Voting Security:** Restricted Securities which do not carry a right to vote, except for a right to vote in certain limited circumstances. These are usually limited to Arrangements.
- **Restricted Voting Securities:** Restricted Securities that carry a right to vote that is subject to some limit or restriction on the number or percentage of securities that may be voted by person, or company, or group. These are most common in highly regulated entities that have restrictions on non-Canadian ownership, and other stuff.
- **Subordinate Voting Securities:** A security that has a right to vote, but the right to vote on a per share basis is lesser than some other class of security.
- **Preference Security:** Under TSX Rules, these must be truly preferred over others. Genuine, non-specious preference - usually a preferred dividend. These are lower on a priority chain, and are not residual equity securities.

Materially Affects Control: Ability of SHs or combination of SHs to influence the outcome of a vote of SHs, including the ability to block significant transactions. This is context and case specific. A 20% holding is presumed to materially affect control, unless the circumstances indicate otherwise.

624 Restricted Securities

(a) One of the principal objectives of this section is to alert investors to the fact that there are difference in the voting powers attached to the different securities of an issuer.
- This section is to be read as a whole and in conjunction with OSC Rule 56-501.

(g) TSX has the discretion to deem and designate or rename a class of securities.
(h) Issuers must notify restricted SHs about all SH meetings
(i) Issuers must clearly describe the voting rights, or lack of such, attached to all shares, in all documents sent to SHs, such as information circulars, proxy statements, and directors' circulars.
(j) All of the above documents and any others, which are sent to SHs, must be sent to all residual security holders, SHs, regardless of their voting rights.
(k) Where TSX requirements contemplate SH approval, TSX may require that the SH approval be given at a meeting at which SHs of restricted securities are entitled to vote with the SHs of any class of securities, on a basis proportionate to their respective residual equity interests in the listed issuer.
- The exercise of this discretion is becoming more and more common.

(l) TSX will not accept for listing classes of Restricted Securities that do not have takeover protective provisions ("coattails") meeting the criteria below. The actual wording of a coattail is the responsibility of the listed issuer and must be pre-cleared.
- If there's a published market for common shares, the coattails must provide that if there's a TOB, the offer must also be made to the holder of the restricted shares through a right of conversion (the restricted shares are converted into the common shares), unless:
  - An identical offer is made to purchase all the restricted shares. This one is the technique relied on most.
  - Less than 50% of the common shares outstanding immediately prior to the offer, other than common shares owned by the offeror, are deposited pursuant to the offer. In this case, the bid is likely to fail.
- If there is no published marked for common shares (in cases where only restricted shares are traded publicly), then holders of at least 80% of outstanding common shares must enter into an agreement with a trustee for the benefit of the restricted SHs, which will prevent transactions that would deprive restricted SHs of rights
- If shares were listed on exchange prior to Aug. 8, 1987 they don't need coattail protection.
  - On exam, shares will be, but STATE the date to show you are aware of it!
- If TOB is structured in a way to defeat objective of coattail provision, exchange may take disciplinary measures?

(m) TSX will not allow issuance of shares that have more voting rights than existing shares
- Unless the issuance is by way of distribution to all holders of the CO's voting shares on a pro rata basis.
- Or unless this is an issuance to maintain, but not increase a proportion of voting rights.
- This section is intended to prevent transactions that would reduce the voting power of existing securities through issuance of securities carrying multiple voting rights.

(n) TSX will not allow for a creation of a new class of restricted securities, unless if there is a minority approval
- Minority approval is the majority of votes, other than votes by:
  - Those with more than 20% of the votes
  - Any associates, affiliates, or insiders of the above
  - Any person excluded by OSC Rule 56-601
  - If none of the above are applicable, all directors and officers of the listed CO

OSC Rule 56-501

- The Rule requires that holders of restricted shares and prospective purchasers of restricted shares be made aware that restricted shares have rights that differ from those attached to an issuer's common shares and that holders of restricted shares receive material sent to holders of common shares.
- The Rule also removes prospectus exemptions and provides that the Board shall not issue a receipt for a prospectus for a distribution of restricted shares unless there is a SH approval, on a majority of the minority basis, was obtained for the distribution or the reorganization that resulted in the creation of the restricted shares.

1.2 Application
- Does not apply to the restrictions imposed by law or restricting foreign ownership
- 2.3 does not apply if 7 days before the finalized document is released, less than 2% of the SHs are in ON, as per the books

2.2 Dealer Advisor Documentation
- If the restricted shares are being traded, the appropriate restricting term must be included in all information and documentation.

2.3 Minimum Disclosure in Offering Documents and Information Circulars
- An offering circular prepared by a Canadian issuer must:
  - Fully describe, using the proper terminology, the restrictions to each restricted share class
  - Include this in large legible font on the first page, followed by a detailed description later.
  - If there is no tight to participate in a bid, it must be said in bold font.
  - Describe the exact voting rights attached to the shares.
  - Describe any significant provisions under applicable corporate and securities law that will not apply to the shares
  - Describe the coat-tails
  - Not misuse the terms "common" or "preferred"

3.2 Prospectus Exemption Not Available
- Prospectus exemptions under ON law are not available for a reporting Canadian issuer, unless the distribution received minority SH approval, or all of the following have been satisfied:
  - Each reorganization carried out by the issuer related to the restricted shares that are the subject of the stock distribution received minority approval.
  - At the time of each such reorganization, the issuer was either a reporting issuer in any jurisdiction or a Canadian issuer.
  - If any proposed uses for the restricted shares were described in the information circular sent to SHs in connection with the SH's meeting held to approve a reorganization referred to above, the reason for the stock distribution is not inconsistent with those uses.

4.1 Determination of Status
- SecCom can determine that the shares of an issuer are in fact restricted.

Saunders v. Cathton Holdings ltd [1997] BC CA
Coattails can be a bitch

Facts: WIC was incorporated under the *OSA* and issued two classes of common shares, voting and non-voting. The non-voting shares were listed on the TSX in 1983 and included a coattail. The question was whether the holders of the non-voting shares, such as CW Acquisition and PL Saunders, were entitled to convert their shares to voting shares as a result of a transaction between Cathton Holdings (D) and Western Broadcasting Company. That transaction occurred in 1994 when D made a private agreement with Western to purchase a substantial block of WIC voting shares from it at a price in excess of the FMV of the publicly-traded non-voting shares. D's offer was rejected by Western but these parties entered into agreements which resulted in Western holding 62.2% of the voting shares while D's holdings of these shares was increased from 11.6% to 28.9%. At all times Western held over 50% of the WIC voting shares and was in a position to unilaterally appoint a majority of the WIC board. D and Western agreed to cause their directors to vote in favour of a resolution that established a two-member executive committee to perform the functions of the chairman of WIC and to vote their shares. The issue was whether Western and D "acted jointly or in concert" so that their shares in WIC would be aggregated and their share purchase and option agreement, from 1994, constituted an offer which entitled holders of non-voting shares to have their shares converted to voting shares. A further issue was whether the reference to the *OSA* in the conversion right articles referred to the 1980 or 1990 version of the legislation, as only the 1990 legislation defined the phrase "acted jointly or in concert". PL claimed that the 1990 legislation applied and that when D and Western acted together it entitled the other non-voting SHs to conversion rights. The trial judge concluded that the 1980 legislation applied because, given the great significance of the voting rights, the parties did not intend to put those rights at risk from the unforeseen vagaries of legislative amendment. Based on such legislation D and Cathton did not act "jointly or in concert" because they had to both be offerors. PL appealed.
Issue: Which *OSA* applies? Did D and Western trigger the coattails by acting jointly?
Discussion:
- Those who invested in WIC securities had to know what they invested in and this knowledge would only exist if such investors knew that the legislation in force at the time would continue to apply.
- There was no basis to conclude that common law rules as to the construction or interpretation of a document would follow the will of the legislature that related to enactments or regulations.
- The language of *OSA* s.88 supported the interpretation given to "jointly or in concert" by the trial judge.
- To fit within section 88(1)(k) a party had to "make offers to purchase or accept offers to sell".
- Since Western neither made an offer to purchase nor accepted an offer to sell, it did not fit within this provision.
- In essence, the 1980 *OSA* did not contemplate the offeror and offeree acting jointly or in concert unless both of them made offers.
- The trial judge ruled correctly when he concluded that the 1980 legislation applied.
- So, whenever drafting a K, it is important to be careful with phrase "as amended from time to time."
    - If phrase is in then the current Act will apply.
    - Coattails can be triggered inadvertently, if people inside a transaction act together.

Ruling: Appeal dismissed.

Insider Trading

The prohibition of insider trading is based on the principle of symmetrical info in the market to allow all investors to have all relevant and equal information to make investment decisions.
- This needs timely and non-selective disclosure, as lack of such would give material advantage to some parties.

Associate: Means, if used to indicate a relationship with any person,
- A partner, other than a limited partner, of that person,
- An issuer of whom the person controls, directly or indirectly, voting securities carrying more than 10%
- A relative, including the spouse, of that person or a relative of that person's spouse, if the relative has the same home as that person;

Insider: Means
- A director or an officer of an issuer, or of a person that is itself an insider or a subsidiary of an issuer,
- A person that has or control or direction over, directly or indirectly, of securities of an issuer carrying more than 10%
  - This can lead to "daisy chains" where insider of an insider will be deemed insider to the third party.
- An issuer that has purchased, redeemed or otherwise acquired a security of its own issue.

Special Relationship: For the purposes of ss. 57.2 and 136, this is:
- Insider, affiliate, or associate of the issuer, the offeror, or anyone proposing to acquire a substantial asset of the issuer.
- Someone who is engaging in a business or professional activity on behalf of the above: lawyers, agents, etc.
- Someone who knows of a material fact or of a material change with respect to the issuer, having acquired it through the special relationship described above.
- Someone who knows of a material fact or of a material change with respect to the issuer, having acquired it from another person, who himself was in a special relationship, as long as he knew or ought to have known of this.
  - These can be mixed and matched with the definition of "insider" to create some tricky combinations.
  - Family members are not caught, except for (c), and the associates sneaking in through (a)
  - Another danger is the daisy chain effect based on the 10% ownership

Material Change: A change in the business, operations or capital of the issuer that would reasonably be expected to have a significant effect on the market price or value of a security of the issuer, or a decision to implement such change.
Material Fact: A fact that would reasonably be expected to have a significant effect on the market price or value of the securities. So a new material fact is not always going to be a material change.

Securities Act BC

57.2 Insider trading, tipping and recommending

(2) A person must not enter into a transaction involving a security of an issuer, or a related financial instrument ... , if the person
- *(a) is in a special relationship with the issuer, and*
- *(b) knows of a material fact or material change with respect to the issuer, ... that. has not been generally disclosed.*

(3) An issuer or a person in a special relationship with an issuer must not inform another person of a material fact or material change ... unless
- *(a) the material fact or material change has been generally disclosed, or*
- *(b) informing the person is necessary in the course of business of the issuer or of the person in the special relationship with the issuer.*

(4) A person who proposes to
- *(a) make a take over bid, as defined in section 92, for the securities of an issuer,*
- *(b) become a party to a reorganization, amalgamation, merger, arrangement or similar business combination with an issuer, or*
- *(c) acquire a substantial portion of the property of an issuer,*

must not inform another person of a material fact or material change with respect to the issuer unless
- *(d) the material fact or material change has been generally disclosed, or*
- *(e) informing the person is necessary to effect the take over bid, business combination or acquisition.*

(5) If a material fact or material change with respect to an issuer has not been generally disclosed, the issuer, or a person in a special relationship with the issuer with knowledge of the material fact or material change, must not recommend or encourage another person to enter into a transaction involving a security of the issuer or a related financial instrument ...

57.3 Front running

(2) For the purposes of this section, a person is connected to an investor if the person
- *(a) is an insider, affiliate or associate of the investor,*

(b) is an investment fund manager of the investor,
(c) is engaging or proposes to engage in a trading or advising relationship with or on behalf of the investor ...
(d) is a director, officer or employee of the investor or of a person described in paragraph (a), (b) or (c),
(e) knows of material order information relating to the investor, having acquired the knowledge while in a relationship described in paragraph (a), (b), (c) or (d), or
(f) knows of material order information relating to the investor, having acquired the knowledge from another person at a time when
(i) that other person was connected to the investor, whether under this paragraph or any of paragraphs (a) to (e), and
(ii) the person that acquired knowledge of the material order information from that other person knew or reasonably ought to have known of the connection referred to in subparagraph (i).

(3) A person that is connected to an investor and knows of material order information relating to the investor must not enter into a transaction involving
(a) a security or an exchange contract that is the subject of the material order information, or
(b) a related financial instrument of a security or an exchange contract referred to in paragraph (a).

(4) A person that is connected to an investor must not inform another person of material order information relating to the investor unless it is necessary in the course of the business of the person or the investor.

(5) A person that is connected to an investor and knows of material order information relating to the investor must not recommend or encourage another person to enter into a transaction involving
(a) a security or an exchange contract that is the subject of the material order information, or
(b) a related financial instrument of a security or an exchange contract referred to in paragraph (a).

Material Order Information: Information that relates to the intention of an investor to purchase or trade a security or an exchange contract, if the execution of one or more orders, the placement of one or more orders to carry out the intention, or the disclosure of any of the information, would reasonably be expected to significantly affect the market price of the security or the exchange contract;
Necessary Course of Business: This is defined in NP 51-201 3.3 on page 26.
Generally Disclosed: This is defined in NP 51-201 3.4 on page 26.

57.4 Defences

(1) A person does not contravene [entering into transaction] *if, at the time the person enters into the transaction involving the security ... the person reasonably believes that the other party to the transaction knows of the material fact, material change or material order information.*

(2) A person does not contravene [tipping] *if, at the time the person informs the other person of the material fact, material change or material order information, the person reasonably believes that the other person knows of the material fact, material change or material order information.*

(3) A person does not contravene [entering into transaction] *if the person*
(b) enters into the transaction as a result of a written legal obligation
(i) imposed on the person, or
(ii) that the person entered into before obtaining knowledge of the material fact, material change or material order information.
(c) ...

(5) A person that is not an individual does not contravene s [entering into transaction or recommending] *if no individual involved in making the decision to enter into the transaction or make the recommendation on behalf of the person*
(a) has knowledge of the material fact, material change or material order information, and
(b) is acting on the recommendation or encouragement of an individual who has that information.

(6) A person does not contravene [tipping] *if, at the time the person*
(a) enters into the transaction involving the security, exchange contract or related financial instrument,
(b) informs another person of the material order information, or
(c) recommends or encourages another person to enter into a transaction,
the person reasonably believes that the investor has consented to the person entering into the transaction or informing, recommending or encouraging.

57.5 Obstruction of justice

(1) A person must not
(a) destroy, conceal, withhold or refuse to give any information, or
(b) destroy, conceal, withhold or refuse to produce any record or thing
reasonably required for a hearing, review, investigation, examination or inspection under this Act.

(2) A person contravenes subsection (1) if the person knows or reasonably should know that a hearing, review, investigation, examination or inspection is to be conducted and the person takes any action referred to in subsection (1) before the hearing, review, investigation, examination or inspection.

87 Insider reports

(2) A person who is an insider of a reporting issuer must, within [10 days] *after becoming an insider, file an insider report in the required form effective the date on which the person became an insider, disclosing*

(a) any direct or indirect ... control ... of securities of the reporting issuer, and

(b) any interest in a transaction involving a related financial instrument if the person continues to have rights or obligations associated with the related financial instrument, or the transaction, after the date the person became an insider.

(3) A person who is an insider of a reporting issuer is not required to file an insider report under subsection (2) if, at the time the person became an insider of the reporting issuer, the person did not have

(a) direct or indirect beneficial ownership of, or control or direction over, securities of the reporting issuer, or

(b) any rights or obligations associated with a related financial instrument or a transaction involving a related financial instrument.

(4) Under subsection (3), a person is deemed to have filed an insider report for the purposes of subsection (5).

(5) If, while a person is an insider of a reporting issuer,

(a) the person enters into a transaction involving a security of the reporting issuer or, for any other reason, the person's ... control ... Of securities of the reporting issuer changes from that shown ... in the latest insider report ... or

(b) the person enters into a transaction involving a related financial instrument,

the person must, within [10 days], *file an insider report in the required form.*

(6) If a director or senior officer

(a) of an issuer is deemed under section 2 (2) to have been an insider of a reporting issuer, or

(b) of a reporting issuer is deemed under section 2 (3) to have been an insider of another reporting issuer,

then, within a prescribed period of time after the date on which that deeming occurs, the director or senior officer must file the insider reports referred to in subsections (2) and (5), for the period for which the director or senior officer is deemed to have been an insider.

Superintendent of Brokers v. Pezim, Page, and Ivany [1994] SCC

The duty on senior officers to disclose material change within ten days includes a duty for senior management to keep informed of material info that exists so it can be disclosed as soon as practicable.

Facts: Ds were directors and officers of Prime, a CO holding several wholly owned subsidiaries and controlling or managing about 50 public junior resource COs. Ds were also directors of Calpine, a CO controlled and managed by Prime. Both COs were reporting issuers listed on the VSE and subject to the VSE's rules and policies concerning public disclosure of information and pricing of options. Both were subject to the continuing and timely disclosure requirements under s.67 of the *BCSA* and to the insider trading provisions under s.68. In 1990, BC Superintendent of Brokers instituted proceedings against Ds in connection with various types of transactions which occurred between July and October, 1989. The Superintendent alleged that the Ds had violated the timely disclosure provisions and insider trading provisions in three categories of impugned transactions: the drilling results and share options transactions, the private placement, and the ALC withdrawal. Ds were prevented from having information relative to assay results by a "Chinese Wall". In the first category, Prime or Calpine failed to disclose all material changes in four transactions in that assay results were publicly disclosed after the CO had granted or repriced options. The second series of impugned transactions involved the private placement of Calpine units. Calpine failed to disclose, contrary to s.67, that Prime was the purchaser and that the sale significantly increased Prime's interest in Calpine. It was also alleged that Calpine had misled the VSE as to the firm brokering the private placement. The third impugned transaction occurred when a broker disputed its contractual obligation either to find a purchaser or to buy a set number of Prime units on offer following the withdrawal of a firm (ALC) from a deal to purchase them. Prime was alleged to have violated s.7 by not making timely and adequate disclosure of the dispute following ALC's withdrawal. BCSecCom concluded that the respondents contravened s.67 of the *BCSA* by failing to disclose material changes in their affairs. No insider trading contrary to s.68 of the *BCSA* was found, however. D's' appeal was limited to whether the BCSecCom had erred as a matter of law in its conclusions on s.67 (disclosure of material change). BCCA allowed the appeal and set aside the BCSecCom's orders.

Issue: What is the definition of "as soon as practicable"

Discussion:

- This case turned partly on the definition of "material change". Three elements emerge from that definition.
  - The change must be in relation to the affairs of an issuer
  - The change must be in the business, operations, assets or ownership of the issuer
  - The change must be "material", as defined in the *BCSA*
- Not all changes are material changes. Material are set in the context of making sure that issuers keep investors up to date.
- The determination of what information should be disclosed is an issue which goes to the heart of the regulatory expertise and mandate of the SecCom, i.e., regulating the securities markets in the public's interest.
- Officers and directors cannot make themselves willfully blind to what is going on in the CO.
- SCC found that Ds breached their duty to inquire. But it did not find insider trading.

- Courts should give considerable deference to SecCom

Ruling: Appeal allowed.

R. v. R.Bennett, H.Doman, and W.Bennett [1989] BC PC

The criminal burden of proof is applicable in persecuting insider trading, and is very hard to meet.

Facts: Doman was the president of DIL, a BC forestry firm, which was a target of a proposed takeover by LP, a large US forest firm. The takeover bid was rumored for a few month prior to being made public in September 1988. At the beginning of this period, the price of DL shares was close to $5. Over the next three months, the price went up to $11.50, rising towards the $12 per share proposed bid. Other two Ds were a friend of Doman, and the friend's brother, and all three had substantial amount of borrowed money invested in the CO. On November 4th, LP made a private call to Doman and told him that the bid was cancelled. Three minutes later, there was a phone call outgoing from his office. Half an hour later, all of Ds have sold their shares. Next day the information of the failed bid went public and the share price plummeted. Crown accused D's of tipping and insider trading.

Issue: Is there enough evidence to prove this?

Discussion:

- Crown has no direct evidence that tipping occurred
- But they claim that the circumstantial evidence is such, that the only reasonable inference is the guilt of the Ds
- To establish the guilt, the standard is BARD
- D B.Bennett has never met D Doman, and has in fact tried selling his shares on November 1, three days prior to the ending of the bid. The order was not filled, but his broker had instructions to sell.
- D. R.Bennett was friends with D Doman, but not engaged in business. The two were avid fans of horse racing. Bennett has also seriously talked with his broker about selling his shares for over a week prior to the sale
- So the only thing in question is whether D. Doman did tip someone with a call right after finding out the news. There was one going out from DIL office to the Bennett office, but there are 15 phones in each office, and there is no way to prove which one phoned which.
- All of the actions of the Ds are generally consistent with the typical market behaviour.
- Though the actions, considered together, can be viewed in a sinister light, the Crown has not proved BARD that the sales were a result of tipping.

Ruling: All D's acquitted.

R. v. Felderhof [2007] ON PC

Insider trading is a pretty hard offence to nail someone with

Facts: AC was hired as Bre-X's in their infamous scam, and eventually became Bre-X's VP of exploration and the vice-chair of the Board. In 1993, Bre-X obtained an interest in some properties that were thought to contain gold deposits. Fake drill results were positive, and Bre-X press releases estimated large quantities of gold. Four press releases in particular formed the basis of the charges. In these, resource estimates were indicated, each of which was higher than the last estimate. However, it was eventually discovered that samples had been tampered with and in 1997, Bre-X issued a press release confirming the negative drilling results that had been discovered, which resulted in the price of Bre-X falling to 90 cents. Between April and September 1996, shares of Bre-X were sold from AC's accounts, totaling millions of dollars. AC was charged with four counts of selling securities with knowledge of material facts that had not been generally disclosed.

Issue: Can they prove anything?

Discussion:

- With respect to the insider trading charges, the court was satisfied that
  - AC was in a special relationship with Bre-X, a reporting issuer, as he was held the position of director, officer and employee at the requisite times and that
  - AC sold securities of Bre-X through his accounts.
- However, the court found that the third element had not been fulfilled, namely that AC had knowledge of material information about Bre-X.
- Specifically, the court found that the facts alleged to be "material facts" that had not been generally disclosed and of which AC had knowledge, were not proven to be "material".
- Regarding the misleading press release, the court found that F took all reasonable care made a due diligence defence.
- Thus, AC was found not guilty of all charges.

Ruling: AC is acquitted.

Special Transactions

After a whole lot of bitching by special interest institutional investors, the MI 61-101 has become the governing statute that covers four types of special transactions:

- Insider Bids
- Issuer Bids
- Business Combinations such as amalgamations.
- Related Party Transactions

It enhanced protection to minority SHs by putting in extra rules for disclosure, formal valuation, and minority approval

MI 61-101 Protection of Minority Security Holders in Special Transactions

- This MI Replaced OSC Rule 61-501 *Insider Bids, Issuer Bids, Going Private Transactions & Related Party Transactions* in 2008.
- There's a Companion Policy 61-101CP, which we never got around to looking at.
- It applies to ON and QB
- Before considering this, it's important to find out if the transaction in question fits into MI 61-101

Interested Party: The definition os this changes depending on a transaction

- For TOB and Insider Bid: The offeror or a joint actor with the offeror,
- For an Issuer Bid: The issuer and any controller of the issuer, or someone reasonably expected to be one after the bid.
- For a Business Combination: A RP of the issuer at the time the transaction is agreed to, who acquires or combines with the issuer, is a party to a connected transaction to the business comb., or is entitled to consideration or collateral benefit.
- For a RP Transaction: A RP of the issuer at the time the transaction is agreed to, who is a party to the transaction, or is entitled to consideration or collateral benefit.

Collateral Benefit: Benefits that a RP of the issuer is entitled to receive (directly or indirectly) due to the transaction or bid. This can include: increased salary, lump sum payment, payment for surrendering securities, other enhancement in benefits related to past or future services.

Prior Valuation: Valuation of an issuer (or its securities or material assets) that would reasonably be expected to affect the decision to act of a SH. This comes into play when there the CO has had a series of valuations done. Prior valuations must be disclosed, so that SHs can see what values have been given in the past. Exception to prior valuation disclosure are:

- A report of a valuation prepared by a person other than the issuer if the report is unsolicited or prepared by someone without knowledge of issuer's material information.
- An internal valuation prepared for the issuer in the NCOB that's not available to the issuer's Board, or any director or senior officer of interested party.
- A report of a market analyst or financial analyst in certain cases.
- A valuation prepared by a person or interested person to be used for an insider bid, business combination or RP transaction.

Part 2: Insider Bids

Issuer Insider: A director or senior officer of the CO or its insider or subsidiary, and anyone with >10% of the voting securities of the issuer.

Insider Bid: Take-over bid made by an issuer insider (or its affiliate) of the target CO. Also includes a person who was an issuer insider (or its affiliate) within 12 month of bid or a person who is a joint actor to anyone above.

2.2 Disclosure

- On top of the disclosure requirements in MI 62-104, there is enhanced disclosure for insider bids.
- Both the offeror and offeree Board, have to disclose all prior valuations of the offeree issuer made in last 24 months, a formal valuation, and all exemptions from 2.4 relied on to avoid this.

2.3 Formal Valuation

- The formal valuation must be undertaken by independent committee of the offeror.
- It must comply with disclosure provisions of Part 6 applicable to it.
- The independent committee of the offeree shall determine who the valuator will be, supervise the preparation of the formal valuation, and use its best efforts to ensure that it is completed and provided to the offeror in a timely manner.

2.4 Exemptions from Formal Valuation Requirement

- There is no need to provide a formal valuation if the deal falls under one of the three scenarios:
  - Neither the offeror nor any of his joint actors has (in the last 12 month), any board or management representation in respect of the offeree issuer, or has no knowledge of any generally material undisclosed info regarding the offeree issuer or its securities. This is most useful for those who fall under the insider definition based on the 10% rule.
  - Previous Arm's Length Negotiations. One needs to satisfy all 7 conditions; mostly to insure a fair bid price and that the offeror does not know of material undisclosed information regarding the offeree.
  - Auction. Three conditions have to be met: that the bid is publicly announced, that there is equal access to information, and that there is adequate disclosure.

Part 3: Issuer Bids

Issuer Bid: Same as MI 62-104. An offer to acquire or redeem securities of an issuer made by the issuer to one or more persons, in the local jurisdiction. The theory behind the policy is that the issuer would know the value of their CO best.

3.2 Disclosure

- The issuer must disclose in the document for an issuer bid:
  - Description of the background
  - Every prior valuation in the last 24 months
  - Review and approval process by the Board and any Special Committee
  - Any dissent opinions and material disagreement between the Board and the Special Committee
  - Anticipated effect of the bid, and a formal valuation.

3.3 Formal Valuation

- Issuer must obtained a formal valuation, in compliance with Part 6, and conducted by an independent committee.

3.4 Exemptions from Formal Valuation Requirement

- There is no need for a formal valuation if:
  - The bid is for securities that are not equity securities, nor are convertible into such.
  - The bid is made for securities, for which a liquid market exists, and will exist after the bid.

Part 4: Business Combinations

Business Combination: This is what used to be called the "going private transactions". Includes transactions like amalgamation, arrangement, consolidation, but does not include:

- A compulsory acquisition of securities required by statute,
- A consolidation of securities that does not terminate SH's interests,
- A termination of sec-holder's interest to comply with legislation,
- A downstream transaction for the issuer.

Downstream Transaction: A transaction between the issuer and a RP of the issuer where the issuer is a controlling person of the RP.

- These transaction or series of transactions which has the effect of transforming a public CO into a private CO and thereby eliminating the public SHs. A going private transaction is typically proposed for one of two reasons:
- The management of the target CO or one or more SHs of the CO wants to buyout the other public SHs and take the CO private; or
- A third party proposes to acquire the target CO either with or without the support of management or a group of SHs.
- This does not apply if issuer is not a reporting issuer, or there are less than 2% of SHs in local jurisdiction, documents re the transactions have been disclosed.

4.2 Meeting and Information Circular

- Issuer proposing the combination must call a meeting of SHs of all securities that will be affected and send out an information circular which includes:
  - The standard disclosure as per MI 62-104
  - Background of the business combination

- All prior valuations and bona fide offers within the last 24month
- Review and approval process by the Board and any Special Committee
- Any dissent opinions and material disagreement between the Board and the Special Committee
- Any subsequent material changes

4.3 Formal Valuation

- If an interested party would, as a consequence of a transaction, acquire or combine with the issuer through amalgamation or arrangement, then the issuer shall obtain a formal valuation.
- If formal valuation is required, the process is the same as in 2.3 and 3.3

4.4 Exemptions from Formal Valuation Requirement

- Formal valuation is not needed in the following scenarios:
- Issuer is not listed on TSX, NYS, AmericaSX, NASDAQ, or a stock exchange outside of Canada and the United States
- Previous Arm's Length Negotiations. One needs to satisfy all 7 conditions; mostly to insure a fair bid price and that the offeror does not know of material undisclosed information regarding the offeree.
- Auction. Three conditions have to be met: that the bid is publicly announced, that there is equal access to information, and that there is adequate disclosure.
- The transaction is a Second Step Business Combination, which has to satisfy 4 conditions:
  - The combination is effected by the offeror that made a bid and deals with shares that were not acquired in that bid
  - The combination is completed within 120 days after expiry date of the bid
  - The price per share that SHs would get here is equal or more than the previous bid price
  - Offeror's intention to do this, and the tax consequences are stated in disclosure document for the bid.
- Amalgamation or Equivalent Transaction with No Adverse Effect on Issuer or Minority, which has to satisfy 5 conditions:
  - There is no adverse tax or other consequences to the issuer, entity resulting from the combination, or beneficial owners of affected securities,
  - There is no material actual or contingent liability of the interested party combining with the issuer that will be assumed by the issuer because of the combo,
  - The RP benefiting from the transaction agrees to indemnify the issuer against any liabilities of the interested party that is combing with the issuer,
  - After the transaction, nature and extent of the voting, and financial participating interests of affected SHs remain the same as before the transaction,
  - The benefiting RP pays all of the costs and expenses resulting from the transaction.

4.5 Minority Approval

- Minority approval for the business combination is required under Part 8.

4.6 Exemptions from Minority Approval Requirement

- Minority approval is not required in these two scenarios, but the exemption relied on and the facts must be disclosed.
  - If one or more interested parties beneficially own the aggregate of >90% of outstanding securities of a class of affected securities at the time the combination is agreed to, and
    - An appraisal remedy is available to affected SHs equivalent to s.190 *CBCA*, or
    - Affected SHs are given an enforceable right that is substantially equivalent to the appraisal remedy provided for in s.190 *CBCA*, and this is described in the disclosure document for the combination.
  - Amalgamation or Equivalent Transaction with No Adverse Effect on Issuer or Minority, as in 4.4 above.
- If there are more than two classes of affected securities, the 90% exemption applies only to the class where the interested parties beneficially own the aggregate of more than 90% of the outstanding securities.

Part 5: Related Party Transactions

Related Party: A RP to a CO is a person, other than a bona fide lender, that, at the relevant times, is known to be:

- A control person of the CO (that is where his shares would let him elect a majority of directors? >20%)
- A control person of control person
  - An RP is a controller of a controller, but not necessarily an insider of an insider of the entity.
- A person of which the CO is a control person,
- A person that has control or beneficially holds >10% of the voting shares of the CO
- A person that substantially manages/directs the CO (that's not acting under bankruptcy or insolvency law)
- A CO of which any of the above has more than 50% of.

Related Party Transaction: Means, for an issuer, a transaction between the issuer and a RP of the issuer (though there can be other parties involved too), where the issuer directly or indirectly:

- Purchases or acquires an asset from the RP for valuable consideration,
- Purchases or acquires, as a joint actor with the RP, an asset from a third party if the percentage of the asset acquired is less then then percentage of the consideration paid by the issuer [CO gets less than paid for]
- Sells, transfers or disposes of an asset to the RP,
- Sells, transfers or disposes of, as a joint actor with the RP, an asset to a third party if the percentage of the consideration received is less than percentage of the asset disposed of by the issuer [CO gets less for its asset]
- Leases property to or from the RP,
- Acquires the RP, or combines with the RP, through an amalgamation, arrangement or otherwise, whether alone or with joint actors
- Issues a security to the RP or subscribes for a security of the RP. [Security exchange with the RP]
- Amends or agrees to amend the terms of a security of the issuer if the security is beneficially owned, or is one over which control or direction is exercised, by the RP. [Change of security terms for RP]
- Assumes a liability of the RP,
- Borrows or lends money to the RP, or enters into a credit facility with the RP,
- Releases, cancels or forgives a debt or liability owed by the RP,
- Materially amends the terms of an outstanding debt or liability owed by or to the RP, or the terms of an outstanding credit facility with the RP,
- Provides a guarantee or collateral security for (or materially amends the terms of) a debt or liability of the RP.

- These are the most complex rules. Important to know if one fits here, and if so, does one fit into one of the exemptions.

5.1 Application

- This Part does not apply to an issuer in a RP transaction if:
  - The issuer is not reporting issuer
  - There are less than 2% of SHs in local jurisdiction, and documents regarding the transactions have been disclosed.
  - This is a downstream transaction
  - This is a business combination of the issuer
  - The transaction is between the issuer and a wholly owned subsidiary, or between sister subsidiaries of the same issuer.
  - And a couple more esoteric ones.

5.2 Material Change Report

- Extensive disclosure in a material change report is required, including:
  - Terms and purpose of a deal, obligations to comply with rules, anticipated effects, interest of all interested parties, review and approval process, prior and formal valuations over the last 24 months, and any exemptions relied on, etc.
- If the report is filed less than 21 days before expected closing date of transaction, the issuer needs to explain in a news release, why this shorter period is reasonable or necessary in the circumstances.
- Any changes may trigger a re-issue.
- Material change reports must be available to all SHs without charge.

5.3 Meeting and Information Circular

- This section applies only to RP transactions where issuer must obtain minority approval under 5.6
- Issuer must call a meeting of SHs of affected securities, and send out a circular, which shall include:
  - A whole bunch of crap, somewhat similar to the disclosure required in 5.2

5.4 Formal Valuation

- This is required for all RP transactions falling under (a) – (g) under RP transaction definition, and is the same as in 2.3

5.5 Exemptions from Formal Valuation Requirement

- Another fucking list of goddamn exemptions.
- Where the FMV of the transaction (or the FMV of consideration) not more than the 25% of the market capitalization of the CO at the time the transaction is agreed to. (This is going to be on the exam, others are not as relevant)
  - If either FMVs is not readily determinable, any determination of value by Board has to be made in good faith,
  - If the issuer (or its wholly-owned subsidiary) is combining with a RP, the subject matter of the transaction shall be deemed to be the securities of the RP held by persons other than the issuer, and the consideration shall be deemed to be the consideration received by those persons [as in the value of RP's shares acquired that issuer did not have before].

    - If the transaction is one of two or more connected RP transactions, add up FMVs for all of those transactions to determine whether this exemption is met,
- Issuer is not listed on TSX, NYS, AmericaSX, NASDAQ, or a stock exchange outside of Canada and the United States
- Distribution of Securities for Cash, (with some conditions)
- Certain Transactions in the Ordinary COB, such as
    - A purchase or sale, in the issuer's OCOB, of inventory (personal or movable property) under an agreement that has been approved and disclosed by issuer Board, or
    - A lease (real or immovable property, or personal or movable property) under a disclosed agreement that is not less advantageous to the issuer than if the lease was with a person dealing at arm's length.
- Transaction Supported by Arm's Length Control Person , based on the idea that a control block holder supporting the transaction is evidence that the valuation is fair.
    - This control person has to beneficially own more securities than the interested party and must not also be an interested party, be at arm's length to the interested party, or be engaged in the transaction.
- Bankruptcy, Insolvency, Court Order
- Financial Hardship: this is a new exemption, for cases where
    - The issuer is insolvent or in serious financial difficulty,
    - The transaction is designed to improve the financial position of the issuer,
    - The issuer has one or more independent directors in respect of the transaction,
    - The issuer's Board and two thirds of issuer's independent directors, acting in good faith, determine, that
        - Subparagraphs (i) and (ii) apply
        - The transaction has reasonable terms in the circumstances.
- Amalgamation or Equivalent Transaction with No Adverse Effect on Issuer or Minority, (same as 4.4)
- Also a couple more, but my head hurts.

5.6 Minority Approval
- Minority approval is required for a RP transaction unless fits into an exemption below.

5.7 Exemptions from Minority Approval Requirement
- Minority approval is not required in these two scenarios, but the exemption relied on and the facts must be disclosed.
- FMV of the transaction (or the FMV of consideration) not more than the 25% of the market capitalization of the CO
- FMV of the CO is less than $2.5m, and this is a distribution of securities for cash.
    - Issuer is not listed on TSX, NYS, AmericaSX, NASDAQ, or some others
    - At the time the transaction is agreed to, neither the FMV of the securities to be distributed, nor the consideration to be received for them, insofar as the transaction involves interested parties, exceeds $2.5m
    - The issuer has one or more independent directors in respect of the transaction who are not employees of the issuer
    - At least two-thirds of the independent directors described above approve the transaction,
- Other Transactions Exempt from Formal Valuation in 5.5: Arms' length control person, OCOB, No Adverse Effect
- Bankruptcy, Insolvency, Court Order
- Financial Hardship
- Loan to Issuer with No Equity or Voting Component, where the transaction is a loan (or creation of a credit facility) obtained from a RP on reasonable commercial terms (not less advantageous to issuer than if obtained from a person dealing at arm's length).
    - Loan must also be non-convertible (into equity or voting secs) or repayable as to principal or interest.
- 90% Exemption, same as in 4.6.
- If transaction is one of two or more connected RP transactions, the FMVs for all the transactions must be aggregated for the minority approval.

Part 6: Formal Valuation And Prior Valuations

6.1 Independence and Qualifications of Valuator
- Formal valuation must be prepared by a valuator that is independent of all interested parties and has appropriate qualifications. This is a question of fact.
- A valuator is not independent if he:
    - Is an associated, affiliated entity or issuer insider of the interested party,
    - Acts as an adviser to the interested party re transaction. However, being retained only for a formal valuation doesn't make you an advisor to the interested party.
    - Is compensated in a way that gives him a financial incentive regarding the conclusion reached in the formal valuation or the transaction's outcome.

    - Is either a manager of a soliciting dealer group for the transaction, or a member of a soliciting dealer group for the transaction, and he performs services beyond the customary soliciting dealer's function or receives more fees than other members of the group,
    - Is the external auditor of the issuer or interested party, unless he will no longer be the external auditor after transaction's completion, which must be publicly disclosed prior to public disclosure of the valuation results.
    - Has a material financial interest in the completion of the transaction,
- A valuator can be paid by an interested party or issuer and still remain independent.

6.3 Subject Matter of Formal Valuation
- There are some exceptions regarding non-cash consideration.

6.4 Preparation of Formal Valuation
- The report must contain a value (or range of) for the FMV and must be prepared in a diligent and professional manner.
- In determining the FMV of affected securities, it must not include a premium for bidders or a discount for SHs
- It needs sufficient disclosure to allow understanding of valuator's principal judgments and underlying reasoning, to be allow readers to form a reasoned judgment of the conclusion.

6.5 Summary of Formal Valuation required.
- A summary needs to be included in the documents, which would be filed with the SecCom

6.8 Disclosure of Prior Valuation required.
- Must state in disclosure documents if there are no prior valuations.
- Some exceptions to disclosure contents of a prior valuation.

Part 7: Independent Directors

7.1 Independent Directors
- It is a question of fact whether a director of an issuer is independent. Apparently shit like this happens on the exam.
- One is not an independent director if the director is
    - Is an interested party in the transaction,
    - Was in the last 12 month, an employee, associated entity or issuer insider of an interested party (or its affiliate),
    - Was in the last 12 month an adviser (or its employee, associated entity or issuer insider) to an interested party of the transaction,
    - Has a material financial interest in an interested party (or its affiliate)
    - Would reasonably be expected to receive a benefit due to the transaction that is not also available to other SHs
- Independent committee members must not receive any payment or other benefit from an issuer or an interested party that is contingent upon the completion of the transaction.
- For an issuer bid, a director of the issuer is not, by that fact alone, not independent of issuer.

Part 8: Minority Approval

8.1 General
- Minority Approval is required for a business combination or RP transaction, involving all SHs of every class of affected securities of the issuer, in each case voting separately as a class.
- This requires a simple majority approval (50%)
- Issuer must exclude the votes attached to affected securities owned or controlled by
    - The issuer,
    - An interested party,
    - A RP of an interested party, or
    - A joint actor with any of the above

8.2 Second Step Business Combination
- Despite 8.1(2), the votes attached to securities acquired under a bid may be included in favour of a subsequent business combo to determine minority approval if
    - SHs that tendered the securities to the bid were not joint actors with the offeror,
    - SHs that tendered the securities to the bid were not
        - A direct or indirect party to any connected transaction to the bid, or
        - Entitled to receive (directly/indirectly) special consideration or collateral benefit.

- The business combination is for the same class of securities the bid was made to and not acquired in the bid,
- The business combo is completed less than 120 days after the expiry date of the bid,
- The consideration per share now is more or equal to the consideration the tendering SHs were entitled to receive in the bid, and
- Disclosure document meets 8 requirements (see MI 61-101)

Part 9: Exemption

- In QB, the securities regulatory authority may grant an exemption to this Instrument, in whole or in part, subject to those conditions or restrictions as may be imposed in the exemption.
- In ON, the regulator may grant an exemption to this Instrument, in whole or in part, subject to those conditions or restrictions as may be imposed in the exemption.