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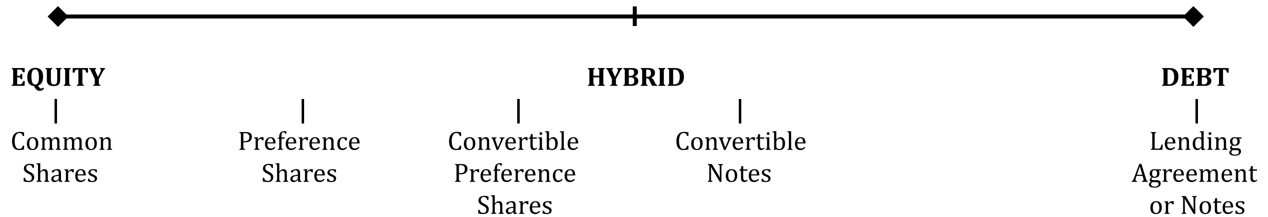
Note to future students: *I wrote this CAN in my second semester of 3L, for the very last exam of my law school career. As such, I was far too lazy to make pretty little case summaries. Sorry. You will just have to live with my unformatted lecture notes. They are not concise but they are thorough. Good luck!*

INTRODUCTION

CAPITALIZATION OF A COMPANY



CORPORATE THRESHOLDS

5% of the common shares of a company: you can **requisition a meeting** (*where you elect Board of Directors*)

10% +1 of the common shares of a company (*blocking position*): you can **block compulsory acquisition** (*i.e. you can prevent being squeezed out*)

33⅓% + 1 of the common shares of a company (*blocking position*): you can **block a special resolution** (*plus: you have hold-out value, which is something you can trade for cash*)

50% + 1 of the common shares of a company: you have **control of the corporation** (*can pass ordinary resolution; can elect board of directors*)

66⅔% of the common shares of a company: you can **pass a special resolution** (*resolutions that change the fundamental nature of the company: selling all or substantially all assets; adding new classes of securities; amalgamation; plan of arrangement*)

90% of the common shares of a company: threshold for **compulsory acquisition**

NB: compulsory acquisition rules are weird in BC: *if you make an offer to 90% of s/h, you have 4 months to make the same offer to the remaining 10% to force them to take it. To make an offer to the remaining 10% after 4 months, you have to get 90% of the shares you don't already own, then squeeze out the remaining 10%. Because of the way it's drafted, it kinda sucks so you never use it.*

NB: for the voting percentages (33⅓% +1 / 50% + 1 / 66⅔%)**:** it is "… of the shares voted at the meeting"! (*so in reality it is more like:* 31% / 47% / 64% *at the most well-attended meeting of all time*)

SECURITIES THRESHOLDS

10% of the common shares of a company: **early warning report** (*you have to tell the world (a) that you got 10% and (b) what your intention is*)

20% of the common shares of a company: **takeover bid threshold** (*i.e. you now have to make the offer that took you across the 20% threshold to everybody else owning those class of shares*)

CAPITAL MARKETS

<u>Capital</u>: Money or right to receive money. Can range from **debt:** a promise to pay a certain amount on a certain date to **equity:** a right to receive an undetermined amount at an undetermined date, should any amount be paid.
<u>Securities</u>: Documents offered in exchange for cash or other benefits, which grant the purchaser a claim on future cash flows or other economic services. *Basically: documents which evidence rights to receive money.*
<u>Liquidity</u>: The ability to convert securities into cash quickly at minimum cost and without a significant decrease in price caused by transaction.
<u>Liquid securities</u>: Securities that can be easily sold at fair market value.

<u>Capital markets</u>: The forums in which different forms of capital change possession. *They perform a public good by allocating capital.*
<u>Primary capital markets</u>: Trade in securities that have been created by the vendor and are sold by the original issuer in order to raise capital.
<u>Secondary capital markets</u>: Trade in securities that are not currently in the possession of their creator. *The vendor didn't create the securities, they just own them.* The key function of secondary markets is to <u>provide liquidity for securities</u> by allowing holders of securities to obtain cash for their securities immediately by selling them to third parties rather than waiting for their value to be realized through some other transaction of the original issuer (whether by purchase of entire company, etc).
<u>Upstairs market</u>: A network of trading desks for 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.

<u>Issue</u>: A sale of security by the original creator (issuer). This is sold through an underwriter to investors, either privately or by way of IPO.
<u>Liquidation</u>: A sale of security by its holder (as opposed to the original issuer).
<u>Control premium</u>: An amount that a buyer is willing to pay over the fair market value of a share. 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 a merger. Normally, the control premium is industry-specific and amounts to 20–35% of the market capitalization of a company, calculated on a 20-trading day average of its stock price.

<u>Pricing Discovery</u>: secondary capital markets establish the <u>market price or value or securities</u>. Knowing the market value of securities permits (1) original issuers to determine how many and what kinds of securities they must sell to raise the money they require (2) holders of securities to estimate their monetary value (3) holders of money to ascertain the merit of exchanging their money for securities. **NB:** *the price as reported doesn't include the value of important thresholds (33⅓%+1 / 50%+1 / 66⅔%*).

BASIS FOR THE REGULATION OF CAPITAL MARKETS

The purpose of primary and secondary markets: (1) they provide a system through which <u>original issuers</u> with an immediate use for money <u>may buy money</u> by selling their securities (2) they permit original issuers to <u>determine how much money they will receive</u> for various kinds of securities (3) they permit holders of money with no immediate use for it to <u>invest in securities</u> with a view to increasing the amount of money they ultimately have (4) they permit holders of securities to liquidate their holdings for money.

Primary goal of securities regulation: to maintain and enhance the efficiency of capital markets and protect the public interest. **Secondary goal of securities regulation:** to provide a capital markets regime that is competitive with other capital market regimes.

The role of capital markets:

(1) The channeling of savings: Markets channel funds from surplus units to deficit units.
(2) 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
(3) 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.
(4) 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.
(5) Valuation basis: Last purpose of financial market is to establish a basis for valuation.

For the purpose of describing capital markets, the economy is divided into two sectors:

(1) 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.

(2) 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.

Dominant Markets in Canada

(1) Money Market: Handles short-term debt securities, usually of one year or less to maturity, issued by governments and both non-financial and financial companies. 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, companies 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.

(2) 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.

(3) 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 MARKETS

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

Listed issuers are required to file audited annual financial statements, which form the basis of most decisions to buy or sell an issuer's securities. Accountants are professionals in examining financial statements of an issuer. They provide an independent expert opinion on the accuracy and method of preparation of these financial statements. They are basically in the assurance business: they provide assurance to regulators and marketplace participants that the statements reflect the underlying reality of the issuer.

Auditors don't provide protection against fraud, what they do is go through relevant audit procedures (**GAAS**) to see whether your financial statements were created using procedures that make them comparable to financial statements (**GAAP**, or the international flavour **IFRS**, which is used in Canada) used by other companies and whether what you've done is reasonable.

Audited statements are usually identical because there is massive stigma attached to having any kind of qualification in your audited financial statements. If you have any qualification in your audited financial statement, everyone drops you like a hot rod.

LAWYERS

The role of lawyers in the financial markets: (1) to ensure that the intent of buyers and sellers of securities is reflected in the documents that evidence the transaction; (2) to monitor compliance with the applicable laws by buyers and sellers; (3) to ensure that a transaction does not violate the public interest in efficient capital markets.

Remember: Lawyers advise, clients act! Lawyers don't act! (*unless they have instructions from client to act as agent*). Lawyers, as intermediaries in the marketplace, are in this strange and somewhat privileged position because they are participants in the marketplace but they are not really participants that are highly regulated, unlike everybody else.

Excerpt by Alboini: Talks about whether or not lawyers, as they participate in the marketplace, ought to have a positive duty to actors in the marketplace other than their client. Lawyers have no liability to anyone in the marketplace except my own client. Should lawyers be responsible to ensure that transactions do not violate the public good of efficient capital markets? Food for thought.

***In the Matter of George C Kern Jr (Allied Stores Corporation)* US SEC 1988**: Lawyers aren't the ones who are supposed to be making the decisions about whether or not something is a material change; that's the client job. The client should have been making the decision about whether or not to file an amendment to the 14d-9 filing. The lawyer, Kern, by being the one who acted, ended up in this weird situation where he couldn't even be punished for what he was doing.

CORPORATE CAPITAL STRUCTURE

CORPORATE FINANCE

The form of organization of corporations represents a method of allocating 3 elements of an enterprise: (1) Risk of loss; (2) Power of control; (3) Participation in the profits (*of the business* while it is a going concern and *in the assets* on the breakup of the company).

A company allocates these elements through the "capital structure," distributing elements of risk, control, and participation by fixing terms of securities and their amounts. Thus, when examining the existing capital structure of a company, the important questions to ask are: (1) Who bears the risk of loss? (2) Who votes, and in what circumstances, and whose votes control? (3) 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 STRUCTURE

Debt Securities: Create a debtor-creditor relationship between the securities holder and the company. These are comprised of bonds, debentures, and notes.
Equity Securities: Shares of a company that create a shareholder relationship.
Shares: A measure of interest of the holder, but not part ownership in assets or company undertaking. This is the only form of security issued by a company which represent an investment that doesn't result in a debtor-creditor relationship. It does not mean part ownership of company's assets. Ownership of a share gives a shareholder 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 company 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 company's operations.

FINANCIAL STATEMENTS

(1) Balance Sheet: A summary of the financial balances of a company. Assets, liabilities and shareholder 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.

(2) Income Statement: 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 company made or lost money during the period being reported. Serves as a valuable guide in anticipating how the company may do in the future.

(3) Retained Earnings Statement: Explains the changes in a company'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.

REGULATION OF CAPITAL MARKETS

SOURCES OF SECURITIES REGULATION

In Canada, each province and territory has a securities regulator and statute, and there is no federal regulating agency (which is ridiculous because there is nothing provincial about securities markets, they are actually international). Most commonly, transactions will fall under twin jurisdiction: the province where the company originates, and Ontario, the centre of the universe (*i.e. where most lenders or buyers are, and in the case of listed companies, where the TSX is*).

Sources of Securities Regulation in BC: (1) BC *Securities Act* (BCSA) (2) Regulations to *BCSA* (3) Rules to *BCSA* (only *BCSA* + *Rules* and *Regs* have force of law; administered by BC Sec Com) (4) By-laws and Rules of SROs (do not have force of law, but their breach will be treated like breach of law) (5) National Instruments (*adopted by all provinces*) and Multilateral Instruments (*basically adopted by ON and QC*) of the provincial securities administrators (have force of law) (6) Policy Statements of the provincial securities administrators. (NPs and UPs) (like by-laws, these have no force of law but breach can be treated like breach of law).

NATIONAL INSTRUMENT NUMBERING SYSTEM

1– Procedure: (11–15)
2– Certain capital markets participants: Regulation of stock exchanges and other SROs
3– Registration requirements: All about the investment dealers, registration of primary participants, etc.
  NI 33-103 exemption: If you're not a regular trader in securities, you're exempt – this exempts everybody
4– Distribution requirements: All about what the prospectus has to look like, and what the exemptions are.
  NI 45-106: Rules for what are exempt offerings of securities
  NI 45-102: Rules for resales of securities
5– Ongoing requirements: *i.e.* continuous disclosure requirements
  NI 51-102: Having to file your financial statements
6– Takeover bids: Sets out the rules for takeover bids.
  NI 62-104: Main rule for takeover bids
7– Securities transactions outside the jurisdiction: If you're selling in SK, for example.
8– Investment funds: Mutual fund dealers, etc. – *wont' talk about this.*
9– Derivatives: *won't talk about this*

THE ROLE OF THE BC SECURITIES COMMISSION

THE STRUCTURE OF THE COMMISSION

Provincial securities regulators are creatures of provincial statute. The Lieutenant Governor in Counsel appoints the Commission and makes regulations (***BCSA s. 183***). In practice, the regulations are made upon recommendation of the Commission.

The BC Sec Com is an independent, autonomous, administrative tribunal. The mandate of the BC SecCom is to protect the investing public from reprehensible activities such as fraud, manipulation, and misconduct in the marketplace and ensure investors have full, true, and plain disclosure of material facts in disclosure documents relating to publicly-offered securities, and accurate continuing information to assist investor to arrive at informed investment decisions in secondary market transactions.

The Commission is made up of seven commissioners, one of whom is the Chairman and CEO of the Commission. There are no particular qualifications. Members are usually securities professionals, academics, people who are interested in the securities world (lawyers, brokers, etc) and sometimes just regular folks.

The policy goal: let the experts govern the market. Commissioners are people who very rapidly become experts in their position and the government recognizes that so the Commission largely gets whatever regulations it wants made. The provincial government doesn't spend a lot of time second-guessing the Sec Com. BUT the Commission it is hyper-independent and hyper-autonomous because the LG in C largely doesn't know what its talking about so it just passes the regulations – and that's okay.

Courts give immense deference to decisions of the Commission. Unless the Commission has made a plain and vital mistake, its decisions will stand (***Canadian Tire Corp* 1987 ON**). So unless you can point to an error in principle (error of law) or a misapprehension of facts (error of fact), don't bother appealing to the courts. If there is any kind of judgment call, the courts are not going to question the Commission.

The Process: (1) The ED first investigates and makes a recommendation for voluntary compliance – that person would refuse. (2) The ED would then go to the Commission and request a hearing. After the hearing, the Commission makes a decision. (3) You can appeal the decision to the court with leave but good luck!

THE POWERS OF THE COMMISSION

(1) The Commission has the power to **grant, suspend, and cancel registration** of participants (*so they can kick you out of the marketplace essentially*). This is important because under under securities laws, if you're going to participate in the public markets, you have to **register** (unless there is an exception). But this is mostly used to govern the brokers, not the issuers.

(2) The Commission also has the power to issue a **cease-trade order** (*the swiss army knife power*). The definition of "trade" in the Securities Act is very broad: "any act in furtherance of a trade is itself a trade" (i.e. if you're doing *anything* in the securities market, its an act in furtherance of a trade). This is pretty large because they can essentially enjoin anyone from taking acts in furtherance of a trade.

(3) The Commission (usually the executive director/CAO) can also grant **exemptive relief** from the statute: if you are confronted with a situation where the rules won't let you do what you think you need to do, you have the ability to go to the Commission and ask for a one-time get out of jail free card, which says: *notwithstanding that the rules don't allow you to do this, we're going to let you do it.* So just because you find yourself in a situation which is barred by the rules doesn't mean you're done. If you think that the rationale for what your client is up to meets the **policy goals** of the Commission, then you can go make a pitch – argue, advocate.

(4) The Commission can also grant **blanket orders:** Sometimes they'll get asked to give the same exemptive relief over and over again and they realize there really is no situation in which they wouldn't give the exemptive relief so they make a blanket order and say everyone gets this relief .

Ex. **Policy can trump the Act:** ***BCSA s. 50(1)(c)*** says you are not allowed to *state* in a prospectus that you're going to seek listing on a stock exchange (*probably because the regulators were worried that people were buying on a promise of liquidity that was never delivered on*). So the Commission made a blanket order on the basis of its general/broad powers: ***BC Notice 47-701*** says ignore that rule, go ahead and make the statement in your prospectus.

(5) The Commission also has **"public interest" jurisdiction**, which is a broad and unfettered power that allows the Commission to make orders to stop a trade (cease trade order) which it deems to be **contrary to public interest** – those orders can be directed at actions that are abusive of the marketplace even if no breach of the Act or regulations is present So a cease trade order is not limited to situations where there is a violation of the Act or Regulations – it can also be used pursuant to the Commission's "public interest" jurisdiction.
Canadian Tire Corp **1987 ON**: *Billeses trying to not share control premium with the little guys,* ***held:*** *allowing coattail to be circumvented while allowing control premium to be captured by the seller is abusive of the market and would erode public confidence in Canada's capital markets*

Selkirk Communications **1988 ON,** *the only reason the opportunity existed for Southam to purchase Cablecasting's shares at $26.50 was because of Southam's own refusal of Rogers's bid,* ***held:*** *this was prejudicial and abusive of the marketplace, even though rules were complied with, OSC did not allow Southam to move forward, invoked public interest jurisdiction*).

NB: the court in ***Canadian Tire Corp*** acknowledge that the Commission should only act if clear evidence of abuse of the marketplace is demonstrated. Abuse does *not* equal unfairness. Abuse has to have a systemic quality. There has to be a broad impact on capital markets in general for an action to be abusive in the sense that it supports an action by the Commission to take the cease trade order pursuant to the public interest jurisdiction. So it's a broad jurisdiction but there has to be abuse there to support the use of the jurisdiction. *Nevertheless, if you brought an action to try to say that a cease trade order founded on a public interest jurisdiction was improper because it was not founded on an action that was "clearly abusive of the marketplace," this is a loser of a case – think of something else.*

NB: If the rules have been complied with, OSC can't just reach in to an averaging period (in the context of a 20-day volume-weighted average price) and take out the days that were abnormal (***Selkirk Communications*** **1988 ON**, *Southam complied with rules: offered within 115% of the volume-weighted price over 20 days, held: 6 days of abnormally high share price should not excluded from volume-weighted average price*).

POLICIES OF THE COMMISSION

The Commission also has **policy-making power**, which they act on through the **Canadian Securities Administrators** (CSA). Officially, the SCA is just a small group in Ottawa that sponsors meetings between the various commissions where they get together to coordinate ruling efforts. Unofficially it kind of acts like a Canadian Securities Commission though it has no power on its own.

Each province sends delegates to the CSA to talk about policy initiatives. They come up with ideas for changes and they take those back to their respective provinces. Then they take that to the LG in C and say, we have a new regulation we would like to put in place. So the regulations come out through this talking shop, then get adopted individually in each of the jurisdictions.

Problem with this: you end up with this mosaic of regulations – you don't have homogenous regulation across the country. They're close enough that you can largely get stuff done but it is different enough that it has traps for the unaware.

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.

Two main SROs:

(1) **IIROC: Investment Industry Regulatory Organization of Canada:** An SRO in the sense that members of the investment industry get together and set standards by which the investment industry operates on a very granule level (it is the successor to IBA and MRS post 2008). Two main bodies of rules: (a) Dealer Member Rules; (b) UMIR: Uniform Market Integrity Rules.

(2) **TSX (TMX): Toronto Montreal Stock Exchange:** Has 2 exchanges: TSX (the senior exchange) and TSX-V (the junior exchange).They both have listed company manuals which contain rules that those who are listed on the exchange have to abide by or they run the risk of losing their listing, but the TSX-V has a lower threshold for listing.

Advantages for effective system: (1) Government agency can devote resources to other activities; (2) Industry association may be able to employ more effective disciplinary techniques than government agency; (3) Business practices and moral standards are more readily understood by people in the industry; (4) Industry association can be organized on a national basis without any constitutional difficulties.

The problem with SROs: they have no power of enforcement except kicking out the guilty party – delisting in the case of TSX, which would just screw over the investors of the delisted company and the Commission would be unimpressed since it is a fan of public interest. ***Torstar and Southam case*** started a wave of TSX accessing the Commissions to help them police rogue companies.

Torstar Corp and Southam Inc **1968 ON:** *Torstar and Southam conducted a share exchange without waiting the requisite notice period required by TSX (they were trying to entrench themselves), TSX didn't want to delist them since this would simply hurt shareholders, so it applied to OSC for a sanction against the companies,* ***held:*** *OSC left the transaction alone but all the directors in both the organizations were prohibited from acting in the markets for 6 months (essentially, they all lost their jobs).*

REGULATION OF TAKEOVER BIDS

When it comes to take over bids, the regulators are concerned with the rights of the holders of common shares of the target company, and any other securities that have a conversion right. The principal cause for the regulation is to protect the public interest. The primary legislative focus is to protect the interest of the target company's shareholders. In BC, these are governed by the ***MI 62-104***, and ***BCSA Part XIII***.

Advantages of friendly transaction (amalgamation or plan of arrangement): (1) You get access to confidential information; (2) You can get a no-shop clause (*they won't go look for a white knight*); (3) You can negotiate a break-free (*if you go hostile, the target company will offer a break-fee to the white knight*); (4) Could result in a tax structure that is more favorable to shareholders; (5) The acrimony of a hostile takeover sucks. Also: From a transaction costs standpoint, takeover bids are extremely expensive (lawyers, financial advisors, proxy solicitation firms, and if you end up winning, all costs incurred by target company end up being paid by you). Advantages of going hostile: (1) The board of directors of the target is entrenching themselves, so you want to get around them to let the shareholders decide; (2) You are in control of the timing (*takeover bids have to be open for 35 days, so if someone comes in after you, your offer will get into hands of shareholders before theirs*).

Takeover bid: 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 offer (***MI 62-104 s. 1.1***).

Breakdown of the definition: "offer to acquire": I have made an offer or I have accepted someone else's offer (captures the seller or buyer) // "outstanding securities": secondary capital markets are markets in which securities are already outstanding, so its not a takeover bid if you're buying from the treasury itself in the primary market // "voting or equity securities": a voting security is one that has a vote, an equity security is one that may be non-voting but otherwise participates in the return of capital upon liquidation of the company, has a right to participate in dividends, etc // "together with the offeror's securities": so it counts a toe hold that the offer might have acquired // "constitutes 20% or more of the outstanding securities of the class": in Canada, there is a hard line of 20%, as long as you are below 20%, there is no takeover bid.

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: (a) no valuable consideration is offered or paid by the issuer for the securities, (b) 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 (c) the securities are debt securities that are not convertible into securities other than debt securities (***MI 62-104 s. 1.1***).

Difference from takeover bid: the company who issued the security wants to buy back its own securities. An offeror of an issuer bid is required to issue an **Issuer Bid Circular** with contents similar to a takeover bid circular (***62-104 s. 2.10; 62-104F2***). **NB:** private agreement exemption is *not* available for issuer bids (*as an issuer, you can't pay someone premium and not others*).

Deemed beneficial ownership: For purposes of determining the number of securities of a target held by the offeror, the offeror is deemed to have beneficial ownership of equity securities if: (1) they are the beneficial owner of a security which is convertible into that equity security and have a right to convert it within 60 days or (2) they have a right or obligation permitting or requiring them to acquire the equity securities within 60 days. (***62-104 s. 1.8***). *Does not apply if acquisition is part of a lock-up agreement in context of tendering process.*

Acting jointly or in concert: People are ***irrebuttably*** **deemed** to be acting jointly or in concert, where: (1) There is an agreement, commitment or understanding, to acquire or offer to acquire securities of the same class or (2) The other party is an affiliate of the offeror (offeror has >50% ownership). People are ***rebuttably*** **presumed** to be acting jointly or in concert, where: (1) There is an agreement, commitment or understanding, and intention to exercise voting rights or (2) The other party is an associate of the offeror (offeror has >10% ownership) (***62-104 s. 1.9***). **It is a question of fact** as to whether a person is acting jointly or in concert with an offeror. *Does not apply if acquisition is part of a lock-up agreement in context of tendering process.* So if the extent of your agreement with the offeror is a lock-up agreement (*i.e. all you're doing is agreeing to tender your shares to the bid*), that does *not* make you a joint actor.

PRE-BID CONSIDERATIONS

(1) **Insider trading issues:** (see section on "insider trading")

(2) **Pre-bid integration rules:** Concerned with the transactions made in the 90 days prior to the bid. Pre-bid integration rules are triggered when an offeror has purchased shares within 90 days prior to a takeover bid, in a transaction not generally available on identical terms to other holders of that class of securities. The offeror must offer the highest consideration paid and acquire the percentage of securities equal to the highest percentage acquired from an individual holder from previous transactions (***62-104 s. 2.4***).

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

(3) **Toe-hold in the company:** if you have a toe-hold in the company, the rule in Canada is that the shares you held prior to your bid cannot be counted in the vote of whether your second-stage transaction is approved by a majority of the shareholders, *so your toe-hold may not count for purposes of the vote to squeeze out the minority, but the larger toe-hold you have, the less competing securities there are* (See Business Combinations).

(4) **Early warning disclosure:** if you acquire 10% or more voting or equity shares in a company, you must file (in addition to an insider report) an early warning report stating how many securities you have, what recent purchases you made, and what your intentions are, and *if your plan changes over time, you have to amend your early warning report.* **Note:** early warning requirements kick in at 5% in the face of a bid. *So if Acquiror makes a takeover bid on Target Co., and a white knight acquires a 5% interest in Target Co., early warning disclosure requirements kick in.* For every 2% increment thereafter, a new report has to go out. **Between 10% and 20%:** you also have to step out of the market for at least 1 clear trading day to allow the disclosure of the fact that you're accumulating to get disseminated in the market.

RULES REGULATING TAKEOVER BIDS

MI 62-104 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.

MAKING A BID

An offeror must commence its bid by publishing an ad in a major daily newspaper and sending the bid to all shareholders (***62-104 s. 2.9***). The offeror must also issue a **Takeover Bid Circular** (***62-104 s. 2.10***; ***62-104F1***). The offeror must make the bid to *all* shareholders of the class of securities in the local jurisdiction (***62-104 s. 2.10***). The **Takeover Bid Circular** outlines: (1) What the offer is; (2) What the conditions to the offer are; and (3) What the mechanics for tendering are (*routine for every deal, but have to be complied with*).

NB: An offeror *can* launch a TOB by press release but typically the press release won't do that. *Why?* **Poison Pills** are allowed for 60 days from date of *announcement* of TOB. So if the offeror *announces* the TOB on Day 1, he will wait until Day 20–25 to *mail* the TOB Circular to avoid giving away the terms of their bid too soon.

Offers must be outstanding for a minimum of 35 days so the directors in the target company can reasonably consider the offer and also try to find other bidders (***62-104 s. 2.28***). An offeror must not take up securities deposited under a bid until the expiration of 35 days from the date of the bid (***62-104 s. 2.29***).

If there are any material changes in the ***terms*** of the offer, the bidder must issue a **Notice of Variation** to the bid document and issue a news release (***62-104 s. 2.12***; ***62-104F5***). If the offer is changed within 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.

If there are any material changes in the ***information*** contained in the bid document, the bidder must issue a **Notice of Change** to the bid document and issue a news release (***62-104 s. 2.11***; ***62-104F5***).

Shareholders have a right to withdraw their shares from a bid: (1) Any time within the first 35 days (***62-104 s. 2.30***) or (2) Within 10 days of a Notice of Change or Variation to the bid document.

TARGET COMPANY'S RESPONSE

Within 15 calendar days after the Takeover Bid Circular is *mailed* (not *announced*), the Board of Directors of the target company must send out a **Directors' Circular** (***62-104 s. 2.17; 62-104F3***) either:
(a) recommending that shareholders accept or reject the offer; (b) advising that the Board is not making a recommendation and giving reasons why; or (c) advising that the Board is still considering the bid and will give a recommendation before the bid is finalized.

Note: *If the Board gives no recommendation, the Board is under an obligation to amend the Circular if a choice is later made; in either case, not less than 7 days before the expiry of the bid, the Board must give a final recommendation, even if it is that they are still not making a recommendation*).

If the directors can't agree, the company must publish dissenting views of any directors in an **Individual Directors' Circular** with reasons and issue a news release (***62-104 s. 2.20***)

If there are any material changes to the information contained in the Directors' Circular, the Board of Directors of the target company must issue an **Notice of Change** to the Directors' Circular (***62-104 s. 2.18***) (*ex. you enter into an agreement with a white knight*).

THE OFFEROR'S OBLIGATIONS

Price/Consideration: One of the fundamental rules in Canada in takeover bids is equal treatment: all shareholders must be treated fairly and equally. An offeror must offer the **same price/consideration to all shareholders** of the target company (***62-104 s. 2.23***). An offeror, or anyone acting jointly with him, **cannot enter into collateral agreements** that have the effect of providing a shareholder with greater consideration than other shareholders of the same class of securities (***62-104 s. 2.24***). **Note:** *this doesn't apply to some employment compensation, severance or other employment benefit arrangements. Also doesn't apply if offeror tries to induce directors or executives to stay with the company after take-over.*

Conditions: The bid document often contains massive conditions. The only condition you cannot include in a Canadian takeover bid circular is a condition for financing. Anyone who is making a takeover bid has to have his financing arranged prior to making the bid (***62-104 s. 2.27***).

Filing of documents: An offeror is required to file copies of any material contracts or documents relating to the bid, including lock-up agreements (***62-104 s. 3.2***).

Restrictions on acquisitions during take-over bid: If you make a takeover bid, you can only buy shares pursuant to your bid (***62-104 s. 2.2***). One Exception: you can buy shares *if* (1) you disclose in your bid circular or news release that you will buy shares through the facilities of the TSX; (2) you can't buy more than 5% of the outstanding shares of that class; (3) the purchase is made in the normal course on a published market; (4) you issue and file a news release immediately after market close each day on which you have purchased securities under this exemption disclosing: (a) the name of the purchaser, (b) the number of securities purchased, and (3) the highest price paid (*you can't pay higher than market price, and you can't pay more than the price of your bid*).

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 (***62-104 s. 2.5***) *i.e. you can terminate your offer and tender to somebody else who may come along, but absent another offer, you can't sell your securities within 20 business days after the expiry of your bid.*

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 (***62-104 s. 2.26***) *so the offeror has to buy those shares pro-rata from what is deposited into the offer, he can't pick and choose from which shareholders to purchase.*

Cont'd

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 (*otherwise, shareholders can withdraw their shares from the bid, **s. 2.30***). 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 (***62-104 s. 2.32***).

Return of deposited securities: Offeror must return all shares that are not taken up, or that he knows that he will not take up (***62-104 s. 2.33***).

News release on expiry of bid: Offeror must notify the market when bid has expired (62-104 s. 2.34).

EXEMPTIONS TO TAKEOVER BID RULES

Normal course purchase exemption: Acquiring less than 5% of the shares at FMV makes one exempt from the takeover bid rules. **4 conditions:** (1) The bid is for less than 5% of the outstanding securities of a class, (2) 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 (*note:* only percentage in excess of 20% counts in the 5%), (3) There is a published market for the class of securities that are the subject of the bid; (4) The value of the consideration paid for any of the securities is FMV (***62-104 s. 4.1***).

So this permits the acquisition of not more than 5% of the outstanding securities during a period of 12 months provided that the price you pay is not in excess of the market price plus reasonable brokerage fees or commissions (i.e. not a premium price).

Private agreement exemption: Acquiring less than 5% of shares at less than 115% of FMV makes one exempt from the TOB rules. **4 conditions:** (1) Purchases are made from less than 5 people; (2) Bid is not made generally to shareholders of that class (if there are more than 5 security holders of the class); (3) If there is a published market for the securities acquired, price paid must less than 115% market price, based on a 20-day average (***s. 1.11***); (4) 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% (***62-104 s. 4.2***).

So this permits you to acquire shares from no more than 5 persons where the value of the consideration paid, including brokerage fees and commissions, is not over 115% of the market price of the securities.

There is no limit on the number or percentage of shares you can buy (as in ***s. 4.1***) so this enables quicker "creeping." It also allows unequal treatment of shareholders by giving room for 15% control premium in the private purchase agreements but that's not much of a premium (standard practice can go as high as 300%).

Note: If an offeror knows or ought to know that the person selling the shares has acquired them for the purpose of selling them under this exemption, then all the people that that person bought the shares from will count towards the 5 person limit (***s. 4.2(2)***). *Designed to catch people who accumulate shares for purposes of relying on this exemption.*

Non-reporting issuer exemption: Private companies that have no listed shares and no disclosure obligations, are exempt from takeover bid rules (***62-104 s. 4.3***).

Foreign take-over bid exemption: Where less that 10% of outstanding equity interest is held by Canadians (as per addresses in offeree's books) (***62-104 s. 4.4***) *so you don't need to comply with canadian takeover bid rules if you provide the foreign connection documents.*

De minimis exemption: Where there is a minimal connection to the jurisdiction, *ex. there are fewer than 50 shareholders owning less than 2%* (***62-104 s. 4.5***).

DISCLOSURE REQUIREMENTS AND LIABILITY

A lot of information becomes available to the marketplace when a takeover bid is launched. The regulators recognize this and want to encourage it. So the takeover bid rules are designed to give the marketplace sufficient time to consider the takeover bid offer and for an auction to emerge should one be available.

DISCLOSURE REQUIREMENTS

62-104F1 TAKEOVER BID CIRCULAR; *62-104F2* ISSUER BID CIRCULAR

The Bid Circular must contain sufficient information for shareholders to make a fully informed decision (this is the base rule that applies everywhere). **Gut check:** The CEO, the CFO and two other directors must personally certify (*own liability on the line*) that the Bid Circular contains no untrue statement and no omission of a material fact. The offeror must inform the target shareholders of **all material information**.

Difference between TOB Circulars for cash vs. equity offers: if a TOB Circular is for an acquisition to be paid for in shares, then the prospectus rules are incorporated into the TOB form. *So you have to give prospectus-level disclosure.*

This is where it pays off to be **short-form eligible** (*i.e. a Canadian reporting issuer who has a prospectus approved by a Canadian SC which includes continuous disclosure to that SC; AIF on file; audited annual financial statements; and equity listed on an eligible exchange*). If you're short-form eligible, you can use a **short-form prospectus** (***44-101F1***), which allows you to just refer to the prospectus you already have out there in the marketplace, as opposed to a **long-form prospectus** (***44-101F1***) which requires a crap-load more information. This is important from a strategic perspective.

Prospectus rules: If you want to issue shares in a company, you have to give the marketplace all the information they would need to know in order to make an investment in shares. You have to give: (1) All material information about the business; (2) All material information about the risks faced by your business; (3) All financial information (annual audited financial statements and unaudited financial statements for the last quarter); (4) Anything else that is interesting or weird.

62-104F3 THE DIRECTORS' CIRCULAR

The Directors' Circular can: (1) Make a recommendation to accept or reject; (2) Make no recommendation and give reasons (*i.e. the Board is torn*); or (3) Advise that the Board is still considering the offer.

62-104F5 NOTICE OF CHANGE OR NOTICE OF VARIATION

A Notice of Variation is required when there is a variation of a term of the TOB. A Notice of Change is required when there is a material change to the *information* contained in a TOB Circular or the Directors' Circular, which can reasonably be expected to affect the decision to accept or reject the bid.

What is "material"? Any information that would reasonably be expected to have a significant effect on the market price or value of the securities. *So if you think this information might sway shareholders' decision on whether or not to sell at this price, then it is by definition, material.*

The OSC has held that **information as to whether or not shares will be withheld from tendering,** while not official and not absolute**, is material** (***Royal Trustco* 1981 ON**, *dissent: if you publish numbers on how many shareholders are not/going to tender, the OSC would come after you for publishing those kinds of vague numbers because it is speculative – you have no basis for reliance on this information*).

An omitted fact is material in the context of a takeover bid if there is a substantial likelihood that a reasonable shareholder would consider the fact important in deciding how to vote/whether or not to tender (***Sparling v Royal Trustco* 1984 ONCA**).

There is an **obligation on an offeror** to tell the target if the offeror **sees more value** in the company, which the target has missed, even if it is based on information that is available to the public. You still have to put it into your circular and failure to do so is a **material omission** (***Fait v Leasco* 1971 US**; *surplus surplus case, **held:** a material part of the evaluation of the company was that excess surplus on the balance sheet*).

STATUTORY CIVIL LIABILITY

If there is a misrepresentation in a circular or any notice of change, the recipients (shareholders) have a right of: (a) **rescission** (called a *put*) or (b) **damages** against: (i) each person who signed the certificate in the circular or notice (*so the CEO, CFO and the two other directors*); (ii) every director of the offeror at the time the circular or notice was signed; (iii) every person whose consent was filed with the circular or notice (*ex. experts, etc*); and (iv) the offeror. There is **deemed reliance** on the misrepresentations (*i.e. the person who acted on the disclosure is not required to show that they actually relied on the information*, *so there is an onus shift to the defendants to absolve themselves of liability*) (***BCSA s. 132(1)***).

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.

STATUTORY DEFENCES

A person is not liable under ***s. 132(1)*** if they prove that the recipient (*who is exercising their right of action*) **had *knowledge* of the misrepresentation** (***BCSA s. 132(4)***). This is the only defence available to the offeror.

A person is not liable under ***s. 132(1)*** if they prove that: (1) they **did not consent** to the circular, or upon becoming aware of the misrepresentation, withdrew their consent (*and gave reasonable notice of the withdrawal*) (***BCSA s. 132(5)(a)(b)***); or (2) **due diligence defence:** has **2 parts:** (a) You have to show that you were diligent (have to do the things that a reasonably prudent person in similar circumstances would do, *i.e. what is standard in the marketplace*), and (b) You have to show that you had reasonable grounds to believe that there was no misrepresentation (***BCSA s. 132(5)(6)(7)***). These defences are only available to the issuer.

OTHER TYPES OF LIABILITY

Aside from civil liability, there are also: (1) **Administrative Sanctions:** You can go to the Commission and ask them to cease trade the bid. But, while the Commission is quite anxious to cease trade prospectus offerings, they don't like to do it in a takeover bid. The rationale is that in a takeover bid, shareholders and the people who are fighting for control of the company can look out for themselves. They have all sorts of remedies available to them and the Commission sees it largely as a place for self-help. So good luck. (2) **Penal Liability:** It is a statutory offence to make a deliberate misrepresentation – *but this doesn't happen too often.* (3) **Common Law Civil Liability:** Just because it is securities laws that are in play doesn't mean we don't have general actions for misrepresentation, breach of fiduciary duties, etc.

DEFENSIVE TACTICS

COMMON DEFENSIVE TACTICS

Defensive tactics have 3 objectives: (1) To increase the price at which the shares trade; (2) To repel a potential hostile bidder; (3) To place or consolidate control with an acceptable person or group (a white knight).

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. *Standstill Agreement provides that for a period of 2 years, unless the Board otherwise agrees, you will not buy any shares, you will not vote shares to displace management, you will not join any other party that is looking to get control.*

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. **NB:** 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.

Other types of defensive tactics: (1) Public relations campaigns; (2) Amendments to the corporation's constating documents to increase share capital or restrict voting shares (*with shareholder approval*); (3) Establishing election of Board of Directors on a staggered basis (if the acquiror tries to take control of the Board through a proxy fight, the most they will be able to get is ⅓ of the board; *Ex:* ***Air Products US Case:*** *bidder's 3 director nominees who were elected to the Board voted against the bidder*); (4) Change the jurisdiction of incorporation (go to a place that had more restrictive rules); (5) Buy back shares (can increase the shareholding percentage of a significant shareholder); (6) Issue shares (in a friendly private placement); (7) Employee benefit stock options and stock purchase plans; (8) Change of control provisions in material contracts (can severely damage the company should that change of control occur and requisite consent not be obtained) (9) If you have cash in the treasury, you can go out and make an acquisition (either diversify the company or using up cash); (10) Restructure the company; (11) Management could get its capital together and make a leverage bid. These have the effect of making the company less attractive to a potential bidder.

COMMON STRATEGIES TO INDUCE A WHITE KNIGHT

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 (usually, if they are unsuccessful in their bid). *Main concern: valuation. If the asset option exercise price is below fair market value, you may have breached your duties to act in the best interest of the company. To protect against this: establish a special committee with independent financial advisor to determine valuation of asset.*

Share Option: White knight may ask for a share option at the price that the competing bid is priced at (would do this if they think the hostile bidder might raise its price). *Problem with this: if the effect of the transaction is to tilt the balance of control of the company by effectively vesting control in the hands of somebody through this issuance of shares, you might be seen to be preferring somebody in the face of this transaction. Onus may shifted to Board to prove that this grant of option is fair.* Note: this is more common in the US.

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/soft lock-up allows offeree to withdraw if a better offer comes along. Closed/hard 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*: TAKEOVER BID DEFENSIVE TACTICS**

Commission's position on defensive tactics: Management of the target company may take one or more of the following actions in response to a bid that it opposes: (1) Attempt to persuade shareholders to reject the offer; (2) Take action to maximize the return to shareholders, including soliciting a higher offer from a third party; and (3) Take other defensive measures to defeat the bid.

It is the policy view of Canadian securities regulators that **the shareholders of any Canadian company that is the subject of a takeover bid *have* to receive that bid at some point**; the directors **CAN'T JUST SAY NO.** And if they adopt any defensive tactic, if the ***effect* of that defensive tactic** is to prevent the shareholders from receiving the offer, the securities administrators will set it aside to allow the shareholders to choose (unlike the US: ***Time and Warner US Case***).

It's only those tactics that are likely to deny or severely limit the ability of shareholders to respond to a takeover bid which will be responded to by the administrators (***62-202 para 6***). Para 6 seems to suggest that securities regulators will look at the **effect** of what the Board did and if the effect of what they did is to frustrate one of the bidders, the securities regulators retain the option of setting it aside. *So: while under corporate law, you may be found to have exercised your business judgment properly, the securities regulators, through this national instrument, may set aside that very same corporate action.*

The policy approach is that unrestricted takeover bid auctions yield more favourable results. Regulators are prepared to override defensive tactics, especially SRPs, in appropriate cases. 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: (1) There is an issuance of securities representing a significant percentage of outstanding securities of target company; (2) There is a sale or acquisition, or agreeing to such, of assets of material amount; or (3) There is a contract or corporate action that deviates from the normal course of business.

DIRECTORS' DUTIES IN RESISTING A TAKEOVER BID

Prevailing view at common law is the **proper purpose test:** (1) The proper purpose for which the power was conferred to the directors must be determined; (2) It must be ascertained whether the power was actually exercised for that proper purpose (***Hogg v Cramphorn* 1963 UK**; ***held:*** *directors' powers were conferred upon them for particular purposes and the exercise of power for a purpose other than the specific one for which it had been conferred was invalid*). BUT between ***Teck v Millar*** and ***Olympia & York***, we have the establishment of a **new modern framework** in which directors' actions in Canada are to be considered.

BCSC in ***Teck v Millar*** held that it is not sound to limit directors' exercise of their powers to the extent required by ***Cramphorn***. **Directors are entitled to resist a takeover bid** if they meet a **two part test** (**Teck Test**)**:** (1) They must act in good faith in resisting the bid; and (2) They must believe on reasonable grounds that the takeover bid will cause substantial damage to their company's interests. (***Teck v Millar* 1973 BCSC**; *court satisfied that Afton had satisfied their fiduciary obligations so placed burden of proof on Teck to show either (a) directors' purpose for rejecting bid was not in best interest of the company or (b) directors did not have reasonable grounds for believing the takeover bid would have caused the company substantial damage*).

In assessing the best interest of the corporation, Directors may consider a variety of interests: (1) Who is seeking control and why? It is material to assess the reputation of the offeror, previous experiences that people have had with the offeror, policies of the offeror (*we know Teck: as soon as they acquire, they'll just tuck it away as another asset, may develop it, may not; they offered a price better than current price but still less than company was worth*); (2) You're entitled to consider the interests of employees and consequences to the community in general (*employees would probably all get fired*); (3) The impact on the corporation and the shareholders (*look at your long-term values: is this going to have a bad impact/destroy value?*) (***Teck v Millar* 1973 BCSC**; ***held:*** *court should only find directors' exercise of their power to be improper if their purpose was not to serve the best interests of the corporation*; ***if the directors decide the bid is not in the best interest of the company, they are entitled to rely on all of their powers/anti-takeover defenses to prevent it***).

The ONHC in ***Olympia & York*** reinforced the ***Teck*** test for directors' use of anti-takeover defenses and added the **following additional principles:** (1) It is the duty of directors in a take-over contest to maximize the value to all shareholders; (2) Directors are entitled to rely on professional advice as to the adequacy of a bid, and such reliance will constitute evidence of acting in good faith and upon reasonable grounds; and (3) Self-entrenchment will not necessarily be inferred where retaining control is secondary to the primary purpose of acting in the best interests of the corporation and in good faith (***Olympia & York* 1986 ONHC**; ***held:*** *court did not set aside business judgment of directors of Hiram Walker. They acted in good faith and in best interests of the company, so it was irrelevant that they also benefitted from their actions by becoming more entrenched*).
As long as the decision of the Board/special committee is appropriate/reasonable (special committee is established and is advised by independent legal and financial advisors, etc.)**, the business judgment rule will apply**; onus will not shift to the Board to justify their actions (***CW Shareholdings v WIC* 1998 ONPC**, *notwithstanding taint of having CEO on special committee, court was satisfied that in the difficult circumstances faced here, with the first bidder having 35.7% (enough to stop special resolution), then to have a bid at $39, it was an appropriate action by the Board to grant both the break fee and the asset option to induce a second bid*).

Break fees are **appropriate in circumstances where** they are necessary in order to: (1) Induce a competing bid to come forward; (2) Where the bid represents a better value for the shareholders; (3) Where the break fee represents a reasonable commercial balance for the potential negative effect as an auction inhibitor and a potential positive effect as an auction stimulator (***CW Shareholdings v WIC* 1998 ONPC**, *in this case, break fee was 3% of transaction value, in a later case,* ***Pacific Papers,*** *it was 4.5%, norm is 2%* ***courts:*** *under 5% is ok*).

Granting an asset purchase option ("asset lock-up") to a potential bidder **may be a proper and acceptable measure for a target corporation to adopt** as a competitive-bid-stimulating inducement where (viewed in the context of the entire negotiated transaction), it strikes a reasonable commercial balance between its potential negative effect as an auction inhibitor depressing shareholder value and its potential positive effect as an auction stimulator enhancing shareholder value (***CW Shareholdings v WIC* 1998 ONPC**, *based on facts of the case, the fact that it was so late in the process, etc, court upheld business judgment of WIC and didn't shift the onus onto WIC Board to substantiate that what they had done was an acceptable conclusion*). See next page.

Factors to be considered in distinguishing between an asset lock-up which is an auction stimulator and one which is an auction inhibitor (***CW Shareholdings v WIC*** **1998 ONPC**)**:** (a) Whether the process by which the directors of the target company exercised their obligation to maximize shareholder value complied with their duties as target-corporation directors; (b) Whether the overall commercial balance and proportion between the auction inhibiting and auction stimulating effect of such an agreement in the circumstances has been struck, i.e., whether the agreement is likely to preclude further bidding, in the sense of harming or significantly dampening the auction process, and thus deprive the shareholders of potential additional value; (c) Whether the price for the optioned asset is within the range of reasonable value attributed to that asset, or whether it represents such a discount that it would result in a disproportionate erosion in the value of the corporation making it uneconomical for others to bid; and (d) Whether the competing bid induced by the asset lock-up agreement provides enough additional value to shareholders to justify granting of the option.

Issuing shares or options: you can't issue shares, the result of which is to dilute shareholding interest of the parties who are in lock-up (***Fibrek:*** *that was probably a poison to its ability to get its action through; contrast* ***Teck****: they issued shares to the friendly party but there was evidence of pre-existing negotiations;* ***Exco Corp*** **1987 NS***: in defending against an unwanted bid, the target company issued shares to friendly shareholders*).

Does *Revlon* apply in Canada? (US) **Revlon Standard:** When a change of control of a company is inevitable, the role of the Board of Directors **shifts from the long term view to maximizing the short term value** (***Revlon v Macandrews & Forbes*** **1986 Del SC**). Effectively, under Revlon, the Directors would become auctioneers charged with getting the best price they can.

Some cite the ***Schneider*** case as holding that ***Revlon*** does not apply in Canada (which is what the decision *explicitly says*) but it more likely stands for the fact that Revlon was not applicable in that particular set of circumstances because the controlling block of shares rendered it inapplicable (***Pente Investment Management v Schneider*** **1998 ON**; *family had controlling block of shares, so only available bid was the one family supported;* ***this was not an auction*** *so Revlon doesn't apply because bid isn't going to highest bidder, it's going to whoever family agrees to sell to;* ***held:*** *directors' obligation is limited to the circumstances: there was only one deal so directors, to have the transaction go forward, were asking appropriately to waive standstill).*

Some cite the ***BCE*** case as holding that Revlon does not apply in Canada but the SCC says that **Revlon does not apply in the context of a plan of arrangement**, because in a plan of arrangement, the obligation of the Board is to consider constituencies other than just the shareholders, including debenture-holders, employees, and the impact on the environment and the community, etc (***BCE v 1976 Debentureholders*** **2008 SCC**).

Commentary: Law firms are applying this decision to takeover bid situations, interpreting these as the duties of directors in *any* context in which a change of control is inevitable. *Problem with this:* BCE wasn't a takeover bid! It was in the context of a fairness application. They were not considering the obligations of the Board faced with a contest for control, structured as a takeover bid. **SO: don't over-read this decision as rewriting the Canadian laws relating to the Board's duties in the face of a takeover bid.**

If Board is disinterested and acts in good faith, its decision will be upheld by the **business judgment rule**. However, in a circumstance where the Board was motivated to entrench themselves and take steps in favour of supporting a friendly bid, they could go over the line where the business judgment rule would not apply if they fail to show they acted fairly (***Unocal v Mesa*** **1985 Del SC**; *US decision but has application to Canada*).

A 2012 QC Sec Com case, ***Fibrek***, is really the first case, by the way it was decided, that suggests that Revlon is not the law in Canada. It seems to suggest that in the context of a change of control, it doesn't always follow that the Board can do anything it can to get a competing bid. Maybe it's that they can't issue shares; maybe that's the line you can't cross (although in this case, short of issuing shares, there was nothing they could do) (***Fibrek and Resolute Forest Products*** **2012 QC Sec Com**; ***held:*** *the granting of securities through an option agreement to preferred bidder had effect of undercutting the bid; they were basically preferring another bidder*).

Commentary: it's possible that a different panel of Sec Com might have decided this case differently because, if you believe that Revlon rules *are* applicable (when change of control becomes inevitable, directors are charged with responsibility of finding best price), there was really nothing else they could do in this case: how do you convince a bidder to come along when the first bid already has 50.7% of the shares locked up?

SHAREHOLDER RIGHTS PLANS

The Commission 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 precedents at the Commission is not the same as in normal Court. The Commission 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 is on the panel you appear in front of.

Securities regulators generally believe that unrestricted auctions provide the most desirable results for the public interest. **In determining whether to set aside a SRP, a balance has to be struck** between allowing directors to protect the company's interest, and allowing shareholders to make a choice by tendering their shares into an offer.

If it is in public interest to do so, the Commission will set aside a SRP (***Inco and Teck Cominco* 2006 On Sec Com**). **BUT** a SRP will be maintained where it protects shareholders from a potential risk of being screwed over (***Falconbridge* 2006 ON Sec Com**; ***held:*** *SRP can stay; Xstrata cannot rely on 5% exemption as it would allow them to end the TOB auction prematurely by giving them a blocking position*).

Commentary: In ***Falconbridge***, the ON Sec Com basically amended, by denying access to an exemption, an exemption that clearly exists in the Act (the takeover bid code allows you to buy up to 5% without violating the law). What is different about this case than the legislative intent that created those rules in the first place? Why deny the ability of a bidder who happens to be under 20%, who makes a takeover bid, who has pre-announced for months their intention to buy 5% pursuant to their takeover bid?

*Prof thinks the OSC got this one wrong Why did they decide to do this? They were motivated by NI 62-202; it is causing them to take away exemptions that exist under the law because they believe if they allow them to do it, that would be an action, not a defensive tactic, but an action that would make it less likely that a takeover bid for **Falconbridge** could be launched even thought legislative intent would have said: well that would have been clear for anybody – why would you provide the exemption if you were going to take it away?*

QUICK RUN DOWN: **Securities regulators basically say that the shareholder should always have the right to decide.** The primary concern in take-over bid regulation is **whether the defence tactics are likely to deny or severely limit the ability of the shareholders to respond** to a take-over bid or a competing bid. BUT the state of law in Canada seems to lack coherence as to how Commissions will rule: we have the original decision in ***Jorex***, then the crazy ***WIC*** decision, and now a non-exhaustive list of factors by a joint panel of the ON, AB and BC Sec Coms in ***Royal Host***. ***Pulse Data*** and ***Neo*** seemed to say that an SRPs is an appropriate response in the face of an unwelcome bid (*i.e. directors can just say no*), but ***Lions Gate*** and ***Baffinland*** quickly laid a rest to that, so SRPs *will* be struck down if they are determined to be against the public interest.

If the Commission finds a Shareholder Rights Plan to be against public interest, as declared in NI 62-202, it will be set aside (***Jorex* 1992 ON**, ***held:*** *SRP struck down; the SRP had the effect of preventing the shareholders from receiving the bid*). *Commentary*: effectively, they were saying, we are not going to concern ourselves with the appropriateness of the directors' conduct, we are not going to focus on whether the directors acted in good faith or in the best interest of the company. In this situation, where they supported a partial bid by an insider over a 100% bid by a third party, it looks like they are entrenching themselves. The facts of the case here suggests that the Board is motivated by an improper purpose.

Contrast rigid application in *WIC*: A week after the adoption of the SRP, a joint hearing of the ON and BC and AB Sec Coms set aside the SRP entirely because it was adopted after the bid was announced (***CW Shareholdings v WIC* 1998 ON**). The Board of WIC, through a special committee with the benefit of independent financial and legal advice, adopted a SRP: it is clear that the SRP is to provide the Board additional time and to effectively prevent CW from purchasing any more shares in reliance of that exemption from the takeover bid requirement, which allows you to buy 5% during the tenancy of your bid. And the Board was successful to get someone else to bid. So the decision of the Commission was very surprising.

In 1999, a joint panel of the ON, AB, and BC Sec Coms in came to the conclusion that it is fruitless to search for the holy grail of specific tests or series of tests that can be applied in all circumstances. Take over bids are fact specific so the relevant factors and the relative importance to be attached to each will vary from case to case. As a result, a test that focuses on certain factors to the exclusion of others will almost certainly be inappropriate in some of the cases to which we attempt to apply it.

SO the Commission got rid of the rigid approach in ***WIC*** and adopted a **broadly contextual fact-specific approach**, setting out a non-exhaustive list of factors to be considered in determining whether it is time for the SRP to go (***Royal Host* 1999 BC Sec Com**, *joint decision of ON, AB, and BC Sec Coms*):

(1) Whether the SRP was approved by the shareholders;
(2) When it was adopted: was it in the face of the bid, prior to the bid, after the bid?
(3) Whether there is broad shareholder support for continued operation of the plan: in some cases, majority of the shareholders say we want the pill to remain);
(4) The size and complexity of the target corporation: if its a complex business, obviously that will take more time for them to find other potential bidders;
(5) Other defensive tactics, if any, that have been implemented by the target company: if such are present, then the SRP is clearly an attempt to frustrate the specific bid;
(6) The number of potential viable offerors: if there are a number of offerors, the SC will be motivated to not let the pill stand;
(7) Steps taken by the target corporation to find an alternative bid or transaction that would be better for the shareholders: if the Board, faced with an offer, is now aggressively going to the market to try to find a competing bid, they are trying to get an auction, and the regulators have said, "we like auctions!" – they think they're the best way to adduce fair value
(8) The likelihood that, if given further time, the target corporation will be able to find a better bid or transaction: If the evidence is that we have confidentiality agreements in place with several parties, 2 parties are trying to arrange financing, etc, commission will take this into account because they want the competing bid to come forward
(9) The nature of the bid, including whether it is coercive or unfair to the shareholders of the target
(10) Length of time since the bid was announced: Regulators pressured by institutional shareholders have agreed to waive 35 day requirement and say it should be ~45–55 days or longer.
(11) Likelihood that the bid will not be extended if the SRP is not terminated: In some of the cases, you find, the bidder (the first one) never says, in response to questions, that I won't extend my bid. When they fail to do that, the Commission has become somewhat suspicious that they're really trying to get the Commission to kill a pill and end the auction to allow their first-in-the-queue offer to get to the shareholders. Whereas, if you really want to win the bid, you're better of saying we don't intend to extend and we don't intend to offer a higher price. At that point, the Commission will say, why are we leaving this in place? If we leave it in place, we're going to deny shareholders the ability to accept their offer

In 2007, the AB Sec Com permitted a SRP to continue, thereby preventing an unsolicited bid from proceeding, even though sufficient time had passed for a competing bid to come forth and even though the target company acknowledged that maintaining the rights plan was not directed at gaining time to seek out alternative bidders. AB Sec Com attached a **great weight to a shareholder meeting** held after the bid was launched and only a week before the hearing, at which holders of **75% of the company's outstanding shares voted in favour of maintaining the SRP** (***Pulse Data* 2007 AB Sec Com**, ***held:*** *shareholders had made informed decision, were given extraordinary amount of information, and Board was highly confident in future/success of its business plan. SC reluctant to interfere with Board's decision given its fiduciary duty to act in best interest of shareholders, especially since decision had been recently approved by informed shareholders*).

BUT note unusual facts of this case: Bid is at a premium. SRP is adopted after bid is launched. Shareholder meeting is convened by management. Shareholders given shitload of information and vote 75% in favour of keeping the pill. In most situations, you would not be able to convene a shareholders meeting that quickly.

In 2009, the ON Sec Com appears to have **approved the reasoning in *Pulse Data*** and suggests that an SRP is an appropriate response in the face of an unwelcome bid. The ON Sec Com decision was significantly influenced by **a shareholder vote to approve the SRP in question** and by a desire to show appropriate deference to the exercise of business judgment by Neo's Board. The ON Sec Com went even farther than Pulse Data, suggesting that even in the absence of a real possibility of an auction, the public interest may lie in allowing the target Board to just say no to an unwelcome bid (***Neo Material Technologies* 2009 ON Sec Com**; *Board was able to produce evidence that they were focused on the long-term business plan and that the long-term business plan is going to produce better results than this unfairly low offer that has come along. Advantage here: the bid that they were defending against was a partial bid (20%, then reduced to 10%) because inherently, partial bids are somewhat coercive*).

BUT for those who were arguing that the ***Neo*** and ***Pulse Data*** reflect a shift in Canada to the US standards, you now have the ***Baffinland*** case that says: We were just kidding! That isn't what we meant at all [*see below*].

BC never followed *Neo* Anyway: In 2010, the BC Sec Com basically said that they do not regard ***Neo*** and ***Pulse Data*** as being precedents because those decisions were limited to their own facts. The decision in Neo and ***Pulse Data*** show a departure from the Canadian securities commissions' view of the public interest as it relates to SRPs. In keeping with the view traditionally expressed by Canadian securities regulators, the BC Sec Com reaffirmed that **SRPs should not deprive shareholders of the opportunity to respond to a bid by tendering to it.** Any reluctance of regulators to interfere with a target Board of the discharge of its fiduciary duties in the face of an unsolicited bid is tempered by the need to protect the public interest by ensuring that shareholders ultimately have the opportunity to decide whether or not to tender into the bid (***Icahn v Lions Gate* 2010 BC Sec Com**).

So Ontario says: "Oops! Just kidding!" In 2010, the ON Sec Com followed the ***Lions Gate*** decision in ***Baffinland***: Consistent with the principles outlined in NI 62-202 and those enunciated in the decision in Lions Gate regarding the importance of shareholders having the opportunity to decide whether to tender to the bid, the ON Sec Com cease-traded the SRP, concluding that the Baffinland shareholders should determine the outcome of the two competing bids (***Baffinland Iron Mines* 2010 ON Sec Com**).

So the ON Sec Com tries to reconcile its decision with the earlier ***Neo*** case: (1) in Neo, **the shareholders had overwhelmingly approved the SRP** in the face of the specific bid; (2) **the Board of Neo was acting in accordance with its fiduciary duties** in having decided not to solicit competing bids. If the Board was not complying with its fiduciary duties, then that might have led the Commission to cease-trade the Neo SRP regardless of the shareholder vote although whether the Commission would have done so is an open question.

ON Sec Com says that ***Neo*** does *not* stand for the proposition that the Commission will defer to the business judgment of the Board of Directors in considering whether to cease trade the SRP or that a Board, in exercising its duties, may just say no. Neo suggests only that **whether or not the board of directors of a target issuer is acting in the best interests of that issuer and its shareholders, and is complying with its fiduciary duties, is a relevant, although secondary, consideration** for the Commission in deciding whether to cease trade a SRP. Whether a Board of Directors is complying with its fiduciary duties does not *determine* the outcome of a poison pill hearing.

Other facts and circumstances that the OSC considered in deciding that granting the cease trade order was in the public interest included that: (1) The rights plan had accomplished the objective of stimulating an auction (*i.e. there were two competing offers on the table*); (2) The rights plan should not be permitted to be used for the purpose only of eliminating a timing advantage available to Nunavut as the first bidder; (3) Immediately cease trading the rights plan could potentially result in a higher offer from Nunavut; (4) The Nunavut offer was not inherently coercive as a result of a minimum tender condition; (5) It was unlikely that Nunavut could acquire sufficient common shares to frustrate the auction; and (6) The terms of the support agreement cannot restrict the OSC's ability to act in the public interest.

In 2012, Quebec also follows the traditional line of cases including ***Lions Gate*** in ***Fibrek*** (SRP is struck down).

EVALUATING DEFENSIVE TACTICS AND RESPONSIBILITIES OF THE BOARD IN THE FACE OF AN UNSOLICITED BID

(1) **Who is the complaining party?** And what are the facts as they relate to that party in this bid?
   (a) Was the bidder initially trying to do a **low-ball bid**? (***Schneider:*** *Maple Leaf offered $19, family felt this was inadequate;* ***WIC:*** *CanWest initially offered low price of $39, went up to $43.50*).
   (b) Has the bidder said it is **prepared to offer more**? (***Revlon* (US)*:*** PP engaged in fractional bidding – this said to Board: before we commit to somebody, we better make sure it is a substantial premium, because unless it is, we might not be acting properly, we should probably engage with bidder).
   (c) Was the bidder trying to slew the company by using a **coercive bidding tactic**? (***Mesa Petroleum* (US):** a known greenmailer was trying to offer to buy the minimum percentage it could to take control – and then undergo a second-step transaction).

(2) **Who is the white knight,** (if any)**?** And is there any evidence of a relationship between the white knight and the target company's Board of Directors?
   (a) Is the white knight already a **related party or an associated company** of the issuer? (***Jorex:*** white knight was an insider bidder, a company set up by CEO – that doesn't feel quite right; ***WIC:*** white knight, Shaw was an insider bidder (had 49.96% voting shares, 15% non-voting shares) – this done's feel all that good either).
   (b) **Is the Board close to the white knight** and is there anything noteworthy about the relationship? (***Revlon:*** Forstmann has a relationship with the Board).

(3) Did the target company's Board do something that **unfairly or at least questionably favored the white knight**?
   (a) **Issuing shares or options** to the white knight (***Fibrek:*** that was probably a poison to its ability to get its action through; contrast ***Teck***: they issued shares to the friendly party *but* there was evidence of pre-existing negotiations; ***Exco Corp* 1987 NS*:*** in defending against an unwanted bid, the target company issued shares to friendly shareholders).
   (b) Did they give away **access to information** that they denied the original bidder? (***Revlon:*** Forstmann was given access to information that was not been given to PP; ***WIC:*** Shaw was being given information by WIC that wasn't being provided to CanWest).
   (c) Did it involve a **CEO on the special committee** or advising the special committee? (***WIC:*** CEO sat on the special committee – it is clear that there was a taint involved at least in the view of the court, it didn't end up disenfranchising the decision the Board made but it made some of the analysis of the special committee come into question; ***Schneider:*** Dodd wasn't on the special committee but he was the principal go-between between the various bidders and Maple Leaf argued that Dodd's involvement in working with the special committee and engaging at the negotiation tainted the result; ***Revlon:*** CEO was heavily involved in negotiating with Forstmann).
   (d) Was an **asset purchase option** granted to the white knight? Court in ***WIC*** says there is nothing inherently wrong with granting an asset option *provided* that the asset option exercise price is at fair market value; ***Revlon:*** in order to induce the better offer from Forstmann, they agree to let Forstamnn buy a significant component of Revlon at a price *substantially below the fair value*: this Board is showing evidence of being motivated by some purpose other than a fair auction).
   (e) Did they **waive the SRP in favour of the white knight** but not the original bidder? (***Revlon:*** did this for Forstmann; ***Schneider:*** did this for Smithfield).

(4) Were the Board's actions designed to **prefer one bidder unfairly against the other bidders**? And did the actions amount to an attempt to end the auction? If there is evidence that what the Board of Directors is doing is so preferring the white knight that they're going to cause the other bidder to go away, those actions will be looked at questionably (***Revlon:*** Board's actions in favour of Forstmann; ***Jorex:*** similar situation with Canadian Trans Arctic).

(5) **<u>Is the original bid unfair</u>** in some way? Was it coercive?
  (a) Is it a **partial bid?** (***Hiram Walker:*** Golf Canada's deal was barely enough to give them control; ***Mesa Petroleum:*** 37% offer was the minimum offer to take control)
  (b) Does it have a **minimum deposit requirement**? (***Sears Canada:*** they changed the bid to get rid of the minimum deposit to try to bring more leverage on the shareholders or coerce the shareholders)
  (c) Is it a **front-end loaded two-tier offer**? (***Mesa Petroleum:*** Mesa's bid for Unocal was a two-tier offer: anyone who didn't get their shares taken up on first offer ended up with junk bonds in second stage).

(6) **<u>When were the defensive tactics adopted</u>**?
  (a) Was it **after the offer had been announced**? (***WIC:*** they adopted the SRP after CanWest's offer was announced and Sec Com got rid of it right away).
  (b) Did the **stock repurchase occur after the bid**? (***Hiram Walker:*** Fingas made the bid after the Golf Canada bid; ***Revlon:*** Revlon purchased the 10 million shares after the initial PP offer)

(7) In the circumstances, **<u>should the directors get the benefit of the business judgment rule</u>**?
  (a) Were the directors **disinterested and independent**?
  (b) Did they act in **good faith**?
  (c) Did they employ a **reasonable decision-making process**? And what did the decision-making process involve? It should probably include the establishment of an independent committee and hiring independent legal and financial advisors.
  (d) Did they establish a **true independent committee**?
  (e) Was the decision at which they arrived **rational**?

  <u>A good way to approach this question</u>: what would it take to find that the Board *shouldn't* get the benefit of the business judgment rule? And shift the onus on the Board to have to prove, through enhanced scrutiny, that they were acting appropriately.

(8) **<u>Depending on the particular facts and circumstances</u>**:
  (a) Under what conditions, if any, should the Board have a **responsibility or duty to find a better offer**?
  (b) Does the Board have to **conduct an auction**? If not, why not?
  (c) Can the Board ever **just say no**?
  (d) Is there a **limit on when the Board can grant asset options**? Or the price they set the asset options?
  (e) Are **break fees** okay? And if so, when wouldn't they be okay?

(9) Does an asset sale/option amount to a **<u>crown-jewel defence</u>**? (***Hiram Walker:*** there is more to HW than just the booze business, it was involved in gas distribution and pipelines. If HW had been the subject of a bid by somebody interested in its liquor business, could the Board had granted an asset option in the liquor business to a competing bidder?). At some point these asset options are going to become so important that the first bidder will go away. *In response:* the hostile bidder might immediately go to court or SC and say: you have to enjoin that sale, you have to stop that transaction because what they're doing is selling the crown jewel of the company and denying shareholders the opportunity to receive my bid because the only thing I'm interested in is that crown jewel

(10)To what **<u>forum</u>** should the matter be brought? Depends on who is complaining about it:
  (a) If you're the hostile bidder, you might get a better decision by the Commission, which wants to see my offer get to the shareholders;
  (b) If you're the Board of Directors trying to defend the actions, you would want the matter considered by a Court, which is inclined to give you the presumptions of the business judgment rule.

RESTRICTED VOTING SECURITIES

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

Restricted Security: All Residual Equity Securities that are not Common Securities.
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 of shares: voting and non-voting.
Common Security: A fully franchised security with an unrestricted right to vote. **Note:** under TSX rules, you can *never* have a "non-voting common share" (you can't use the word "common" to describe anything other than common shares, which are shares that have 1 vote per share and have a pro-rata participation in the economics, *c'est tout*). Similarly, you can't use "preference" or "preferred" in the name of a security unless a non-specious preference is granted (something that *actually* is a preference).

TSX Manual Rule 624 RULES

TSX Manual Rule 624 **sets out rules and fundamental rights for 4 types of restricted securities:**

(1) **Subordinate Voting Securities:** Securities that have a right to vote, but the right to vote on a per share basis is lesser than some other class of security. *So they carry a right to vote, but another class of securities of the same issuer carries a greater right to vote; i.e. there are multiple-voting securities floating around out there.*
(2) **Non-Voting Security:** Securities which do not carry a right to vote, except for a right to vote in certain limited circumstances (*Ex. right to vote through corporate legislation; in a plan of arrangements; etc*)
(3) **Restricted Voting Securities:** Securities that carry a right to vote but are subject to some limit or restriction on the number or percentage of securities that may be voted by person, company, or group. These are most common in highly regulated entities that have restrictions on non-Canadian ownership, and other stuff. *Problem with this:* you end up with securities floating around with these strange provisions in them.
(4) **Preference Security:** Securities that have a genuine, non-specious preference or right over and above residual equity securities (*you have a right that gets triggered before everybody else; so if each common share has a pro-rata entitlement to participate in the residue, a preference share might have the right to $1000 first*).

Right to receive notice of meetings: Whether or not restricted security holders have the right to vote at a shareholder meeting, they must receive at least 21 days' notice of the meeting (***TSX 624(h)***). *Even though they don't get the right to vote, they have to be given the right to attend and speak at the meeting to the same extent that a holder of voting securities would be entitled to attend and speak.* **NB**: *this is a completely empty right.*

Disclosure requirements: Issuers must clearly describe the voting rights, or lack of such, attached to all shares, in all documents sent to shareholders, such as information circulars, proxy statements, and directors' circulars (***TSX 624(i)***). *You have to be very clear as to: What the residual equity securities holders get and what the preference security holders get and how your voting rights work.* **Also:** These documents that are sent to shareholders must also be sent to all residual security holders, regardless of their voting rights (***TSX 624(j)***).

Residual discretion: The TSX always maintains a residual discretion to require that shareholder approval be given at a meeting at which holders of restricted securities are entitled to vote with the shareholders of any class of securities, usually on a basis proportionate to their respective residual equity interests in the listed issuer. (***TSX 624(k)***). *If you're a TSX listed company and you want to do any transaction (one that matters), you need TSX approval (especially anything involving your capital structure). Sometimes, the TSX will use their residual discretion/approval right to say: you want to do this weird, funky thing, we think you're just trying to screw the shareholders, we're not going to let you do it unless you get that group to approve it.*

Coattails: see next page.

COATTAILS

To be listed on the TSX (after August 1987), restricted securities *must* have takeover protective provisions ("coattails") that meet certain criteria below (***TSX 624(l);*** *actual wording of a coattail not given*):

(1) **If there is a published market for the common shares** (*i.e. the common shares are listed*), the coattails must provide that if there is a takeover bid, the offer must also be made to the holder of the restricted securities through a right of conversion (*i.e. the restricted shares would be given the right to participate in the takeover bid by converting into common shares*) **UNLESS** (a) an identical offer was made to purchase the restricted securities **OR** (b) less than 50% of the common shares outstanding immediately prior to the offer, other than common shares owned by the offeror and affiliates, are deposited pursuant to the offer. *Note: there is usually also a clean-up clause: if you convert, you are deemed to deposit into the bid; if you withdraw or the takeover bid transaction goes to shit, you are deemed to convert back to your restricted securities.*

(2) **If there is no published market for the common shares** (*i.e. the common shares are not listed, only the restricted securities will be publicly traded; family company situation*), holders of at least 80% of the outstanding common shares must enter into an agreement with a trustee for the benefit of the restricted shareholders which will prevent transactions that would deprive the restricted shareholders of any rights they *would* have had if they had been holders of common shares.

Focus is different: If the common shares are listed securities, you have to worry about takeover bids. If the common shares are not listed securities, you have to worry about private transactions. **Overall purpose** is to not let the restricted security-holders to be blocked from participating in fundamental transactions on equal footing with the common shareholders. **Note:** If a takeover bid/transaction is structured in a way to defeat the objective of the coattail provisions, the TSX may rear its ugly head and say: *ummm no.*

How to introduce restricted securities into the marketplace:

The TSX will not allow an issuance of shares with voting rights that are greater than those of an existing class of shares on the exchange **UNLESS** the issuance is made to *all* holders of voting shares on a pro-rata basis (***TSX 624(m)***). *If you have an existing public company, and you want to put in place a restricted voting share structure, you (1) dividend out the new multiple voting shares (10-vote class B) to everybody; (2) then you vote to change the original shares into 1-vote or no-vote class A shares; (3) then you do all your offerings from the class A shares. So the dilution that occurs always happens on the class A side and never on the class B side.*

Exception: the issuance 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. *The family has always had 70% of the vote, they're issuing more and more of the 1-vote shares, eventually they can't issue any more because it will drop them to 69%. This exception allows them to maintain their voting position.*

The TSX will not allow for the creation of a new class of restricted securities unless there is minority shareholder approval (***TSX 624(n)***). Minority approval is the majority of votes, excluding votes by: (a) Any person who owns, directly or beneficially, 20% or more of the votes; (b) Any associates, affiliates, or insiders of the above; (c) Any insiders (10% owners, directors, officers); (d) Any person excluded by *OSC Rule 56-601*.

OSC Rule 56-501: **very similar to the TSX rules**

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.

Interpretation of Coattails: see next page.

INTERPRETATION OF COATTAILS

Interpretation of coattails can be a pain in the ass. Case in point: ***Saunders v Cathton* 1997 BCCA:**

WIC had **simple coattails** attached to their listed, non-voting shares: "*If an offer as defined in article 8 is made, then each holder of class B non-voting shares shall be entitled at any time, from time to time, to have all or a part of the class B non-voting shares held by him converted into class A voting shares on a 1:1 conversion ratio*."

The question came down to whether or not Cathton's private agreement with WBC (WIC's majority block-holder) to purchase a substantial block of WIC's voting shares was an **offer:** "*An offer is an offer to purchase a number of securities that if the offeror acquires them, means that they, in connection with anyone they are acting jointly or in concert with, as such term is construed for purposes of the ONSA will own more than 50%*."

The offer here ended up in them owning 28.9% but the argument was that WBC was acting jointly or in concert with Cathton. So the issue was whether WBC was **acting jointly or in concert with the offeror** as such term is construed for purposes of the *Ontario Securities Act*.

Held: Yes, WBC is "acting jointly or in concert with" Cathton as defined in the ONSA BUT they couldn't have meant the term to be as broad as it is in the ONSA because they have language that says "an offer means an offer to purchase or the acceptance of an offer to sell." **If you're going to put two actors together because they are acting jointly or in concert, they have to be acting in the same way** (a narrow interpretation)**.** *Cathton was offering to purchase, but WBC neither made an offer to purchase nor accepted an offer to sell.*

DISCLOSURE OF MATERIAL INFORMATION AND INSIDER TRADING

MATERIAL FACTS AND MATERIAL CHANGE

"**insider**"**:** (a) director or officer of a company; (b) person with 10% of voting rights (through beneficial ownership and/or control and/or direction over, directly or indirectly); (c) director or officer of a person that is an insider of the company (*ex. a D of B Co (10% s/h of A Co, is insider of A Co*) (***BCSA s. 1(1) definitions***).

"**material fact**": a fact that would reasonably be expected to have a significant effect on the market price or value of the securities (***BCSA s. 1(1) definitions***).

"**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 (***BCSA s. 1(1) definitions***). **3 elements of definition:** (a) the change must be in relation to the affairs of an issuer, (b) the change must be in the business, operations, assets or ownership of the issuer, and (c) the change must be "material", as defined in the *BCSA* (***Pezim* 1994 SCC**).

"**material fact**" vs "**material change**": material *fact* is a set of circumstances, a reality that is out there that would affect the market price of the shares but doesn't *change* the structure of the entity itself. A reporting issuer does not need to press release a material *fact* but it does need to press release a material *change*. **BUT: both trigger the insider reporting requirements.** SO: for purposes of insider trading, whether you're in possession of a material *fact* or *change* that has not been publicly disclosed, you're screwed either way.

Changes in assay/drilling results *can* amount to a material change; new information relating to a mining property (which is an asset) bears significantly on the question of that property's value (***Pezim* 1994 SCC**).

The identity of a single (insider) purchaser for a private placement, which could result in a significant increase in the placee's control over the company is a **material change** and must be disclosed (***Pezim* 1994 SCC;** ***held:*** *the identity of the placee (Prime) and the fact that Prime (an insider) would its control over Calpine from 23 to 36%, assuming exercise of the warrants, should have been disclosed;* ***note:*** *today, this would also get caught by insider reporting requirements*).

A negative event, such as an underwriter dropping out of a transaction, constitutes a material change and is a disclosable event (***Pezim* 1994 SCC;** *company did not accurately disclose withdrawal of ALC from financing*).

INSIDER TRADING

THE RULE (***BCSA s. 57.2: insider trading, tipping and recommending***)**:** If you are in a special relationship with an issuer and you are in possession of a material fact or change that has not been publicly disclosed, then you **cannot enter into any transaction** involving a security of the issuer (***57.2(2)***). You also **cannot inform another person** of that material fact/change UNLESS the material fact/change has been generally disclosed or informing the person is necessary in the course of business of the issuer or the person in the special relationship with the issuer (*auditors, underwriters, etc*) (***57.2(3)***). You also **cannot recommend or encourage another person** to enter into a transaction involving a security of the issuer (***57.2(5)***).

A person **entering into a transaction with the issuer** (take over bid, business combination, or acquisition), **cannot inform another person** of a material fact/change UNLESS the material fact/change has been generally disclosed or informing the person is necessary to effect the transaction (*auditors, etc*) (***27.2(4)***).

So the existence of a material fact or change on its own doesn't necessarily trigger the insider rules. Insider rules are triggered when a person is in a "**special relationship**" with an issuer, meaning they are:
(a) an **insider, affiliate, associate of** the issuer or anyone proposing a takeover bid, business combination (*amalgamation, merger, etc*), or acquisition (*of a major asset of the issuer*) (*basically, if you're about to enter into a material transaction with the issuer*); (b) engaging in a business or professional activity with or on behalf of any of the above (*lawyers, agents, etc*); (c) a director, officer or employee of any of the above;
(d) knows of a material fact/change, having acquired it while in a special relationship, as defined above;
(e) knows of a material fact/change, having acquired it from another person who is in a special relationship, as defined above (*the mailman chatting with the CEO*) AS LONG AS that person knew or reasonably ought to have known of the special relationship (*mailman's first day on the job?*) (***BCSA s. 3***).

FRONT-RUNNING

THE RULE (*BCSA s. 57.3: front-running*)**:** If you are connected to an investor and know of material order information relating to the investor, then you **cannot enter into a transaction** involving a security/exchange contract that is the subject of the material order information (*57.3(3)*). You also **cannot inform another person** of material order information relating to the investor UNLESS it is necessary in the course of business of the person or the investor (*auditors, underwriters, etc*) (*57.3(4)*). You also **cannot recommend or encourage another person** to enter into a transaction involving a security/exchange contract that is the subject of the material order information (*57.3(5)*).

"**investor**" means: basically, anyone who is going to acquire securities (*57.3(1)*).

"**material order information**" means: information relating to orders or intention of any potential investor to acquire securities of a company if the disclosure of this information would reasonably be expected to significantly affect the market price of the security or the exchange contract (*57.3(1)*).

"**order**" means an order to purchase or trade a security or an exchange contract (*57.3(1)*).

"**person connected to an investor**" means: a person who: (a) is an insider, affiliate or associate of the investor, (b) is an investment fund manager of the investor, (c) is engaging in a trading or advising relationship with or on behalf of the investor or any person above, (d) is a director, officer or employee of the investor or of a person above, (e) knows of material order information relating to the investor, having acquired the knowledge while in a relationship with any person above, or (f) knows of material order information relating to the investor, having acquired the knowledge from another person who was connected to the investor **and** the person that acquired knowledge of the material order information from that other person knew or reasonably ought to have known of the connection (*57.3(2)*)

LIABILITY FOR INSIDER TRADING

Who can sue: If an issuer, or a person in a special relationship with an issuer, contravenes s. 57.2 (*the insider trading rules*), **any person who incurred losses** in relation to the transaction involving the security (or related financial instrument) **has a right of action** against the issuer or the person in a special relationship with the issuer **IF** the transaction was entered into during the period between when the contravention occurred and when the material fact/change was generally disclosed (*BCSA s. 136(1)* and *(2)*).

Damages: The **amount payable to the plaintiff** is either (a) the losses incurred by the plaintiff or (b) an amount determined in accordance with the regulations (whichever is less) (*s. 136(3)*). 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 fact or change (*BCSA s. 136(4)*).

Due diligence defence for insider trading: A person is not liable under s. 136 if, **PRIOR TO** entering into a transaction, or tipping, or recommending, he conducted a **reasonable investigation** and had **no reasonable grounds to believe that the material fact or change had not been generally disclosed** (*BCSA s. 136.2*).

Willful blindness is not a defence. There is a positive obligation on directors and management to make inquiries to determine whether there has been a material *change* prior to engaging in any securities transactions (***Pezim* 1994 SCC; *held:*** *company was offside disclosure requirements, but not on insider trading*).

NB: Nailing someone with insider trading is not easy! The standard of proof for insider trading is "**beyond a reasonable doubt**" (*criminal standard*) and it is difficult to meet. You need more than mere existence of phone calls; you need to actually prove BRD that the person was in possession of material information and engaging in insider trading (***R v Bennett, Doman and Bennett* 1989 BC**, *horse-trading case;* ***held:*** *though the actions, considered together, can be viewed in a sinister light, Crown had not proved BRD that the sales were a result of tipping;* ***R v Felderhof* 2007 ON**, *infamous Bre-X scam;* ***held:*** *third element (that AC had knowledge of material information about Bre-X) was not fulfilled*).

DEFENCES

Insider Trading: **Transaction** (***s. 57.2(2)***): A person does not contravene s. 57.2(2) if, at the time the person enters into the transaction, the person **reasonably believes** that other party knows of the material fact or change (*ex. reasonable for President to think VP Exploration knew about the drilling results*) (***s. 57.4(1)***).

Insider Trading: **Transaction** (***s. 57.2(2)***) / **Front-Running**: **Transaction** (***s. 57.3(3)***): A person does not contravene s. 57.2(2) or 57.3(3) if the person: (a) enters into the transaction under a written **automatic dividend reinvestment plan**/purchase plan/similar automatic plan, in which the person agreed to participate before obtaining knowledge of the material information, OR (b) enters into the transaction as a result of a **written legal obligation** imposed on the person or that the person entered into before obtaining knowledge of the material information (***s. 57.4(3)***). ***DRIP:*** *As a shareholder, you can opt to get dividends in cash or you can enter into these plans, which take the dividend amount and invest them back into the company.*

Insider Trading: **Transaction** (***s. 57.2(2)***) / **Front-Running**: **Transaction** (***s. 57.3(3)***): A person does not contravene s. 57.2(2) or 57.3(3) if the person entered into the transaction (a) as **agent** under specific unsolicited instructions (*coincidental*), (b) as **agent** under specific instructions that the agent solicited before obtaining knowledge of the material information, (c) as **agent or trustee** for a person because of that person's participation in a written automatic dividend reinvestment plan/purchase plan/similar automatic plan, or (d) as **agent or trustee** for a person to fulfill a written legal obligation of that person (***s. 57.3(4)***).

Insider Trading: **Transaction** (***s. 57.2(2)***) / **Front-Running**: **Transaction** (***s. 57.3(3)***)
Insider Trading: **Recommending** (***s. 57.2(5)***) / **Front-Running**: **Recommending** (***s. 57.3(5)***): A company (not an individual) does not contravene s. 57.2(2) or (5) or 57.3(3) or (5) if NO individual involved in making the decision to enter into the transaction or make the recommendation on behalf of the company: (a) has **knowledge of the material information**, and (b) is **acting on the recommendation or encouragement of an individual who has that information** (***s. 57.4(5)***).

Front-Running: **Transaction** (***s. 57.3(3)***): A person does not contravene s. 57.3(3) if, at the time the person enters into the transaction, the person **reasonably believes** that (a) the investor has consented to the person entering into the transaction, and (b) the other party to the transaction knows of the material order information (***57.4(6)***).

Front-Running: **Recommending** (***s. 57.3(5)***): A person does not contravene s. 57.3(5) if, at the time the person recommends or encourages person B to enter into a transaction, (a) he **reasonably believes** that the investor has consented to the person recommending or encouraging, and (b) he informs the other person (person B) of the material order information AND that they are both connected to the investor for the purposes of section 57.3 (***s. 57.4(8)***).

Insider Trading: **Tipping** (***s. 57.2(3)*** or ***s. 57.2(4)***): A person does not contravene s. 57.2(3) or (4) if, at the time the person informs the other person of the material fact or change, the person **reasonably believes** that the other person knows of the material fact or change (***s. 57.4(2)***).

Front-Running: **Tipping** (***s. 57.3(4)***): A person does not contravene s. 57.3(4) if, at the time he informs person B of the material order information, (a) he **reasonably believes** that the investor has consented to him informing person B, and (b) he informs the other person (person B) that they are both connected to the investor for the purposes of section 57.3 (***s. 57.4(7)***).

Due diligence defence for insider trading: A person is not liable under s. 136 if, **PRIOR TO** entering into a transaction, or tipping, or recommending, he conducted a **reasonable investigation** and had **no reasonable grounds to believe that the material fact or change had not been generally disclosed** (***BCSA s. 136.2***).

Willful blindness is not a defence. There is a positive obligation on directors and management to make inquiries to determine whether there has been a material *change* prior to engaging in any securities transactions (***Pezim* 1994 SCC; *held:*** *company was offside disclosure requirements, but not on insider trading*).

INSIDER REPORTS

All insiders are required to publicly disclose their equity interest in the company of which they are an insider. *Rationale:* the securities regulators/legislators have decided that the public has a right to know when an insider of a company is acquiring or disposing of their shares.

THE RULE (***BCSA s. 87: initial and subsequent insider report***)**:** An **insider of a reporting issuer** (*excluding mutual funds*) **must file reports disclosing** the insider's (a) beneficial ownership of, or control or direction over, directly or indirectly, securities of the issuer, and (b) interest in, or right or obligation associated with, a related financial instrument of a security of the issuer (*so includes warrants, options, debt instruments convertible into shares, etc*). *The specific rules and requirements are set out in NI 55-104.*

Remember: "**insider**" means**:** (a) director or officer of a company; (b) person with 10% of voting rights (whether through beneficial ownership and/or control and/or direction over, directly or indirectly); (c) director or officer of a person that is an insider of the company (*ex. a director of company B, which is a 10% shareholder of company A, would be an insider of company A*) (***BCSA s. 1(1) definitions***).

Exceptions: Early report by control person: If a control person (*defined in BCSA s. 1*) files an early report under ***BC Sec Rules s. 137***, that person is not required to file a report under BCSA s. 87 (***BC Sec Rules s. 158***). Filing in other jurisdictions: If there is equivalent insider reporting requirements in the jurisdiction in which your reporting issuer company carries on its business, and you have filed the reports required by that jurisdiction, you are not required to file a report under BCSA s. 87 (***BC Sec Rules s. 159***).

NI 55-104 INSIDER REPORTING REQUIREMENTS AND EXEMPTIONS

THE RULE (***NI 55-104 Part 3***)**: Insiders must file insider reports** if they are "**reporting insiders**" of a reporting issuer (***s. 3.1***). Their report must disclose their (a) beneficial ownership of, or control or direction over, whether direct or indirect, securities of the reporting issuer, and (b) interest in, or right or obligation associated with, a related financial instrument involving a security of the reporting issuer (*warrants, options*):
(1) **within 10 days of becoming a reporting insider**, (***s. 3.2: initial report***); AND
(2) **within 5 days of changes** to the above, disclosing the changes (***s. 3.2: subsequent report***); AND
(3) **within 5 days of *exercising*** any options, warrants, or other convertible securities, disclosing the resulting changes to the above information (***s. 3.4: convertible securities***). *So if you acquire a warrant to acquire shares, you have to disclose that, then if you decide to exercise your warrants, you have to disclose that too.*

"**reporting insider**" means an insider of a reporting issuer if that person is: (a) **CEO**, **CFO**, **COO**, **director**, **significant shareholder** of the reporting issuer; (b) **CEO**, **CFO**, **COO**, **director** of a significant shareholder of the reporting issuer; (c) **CEO**, **CFO**, **COO**, **director** of a major subsidiary of the issuer; (d) a crap-load of other people and their dogs and (e) **any other insider** that in the ordinary course has access to material information before it has been disclosed and has some sort of power or influence over the business, operations, capital or development of the reporting issuer (***NI 55-104 s. 1.1(1)***).

"significant shareholder" means a shareholder with more than 10% of the voting rights (whether through beneficial ownership, control or direction over, direct or indirect, etc), excluding, for purposes of calculation, any securities held by the person as underwriter in the course of a distribution (***NI 55-104 s. 1.1(1)***).

There are exemptions for things such as **normal course issuer bids** (*if a company acquires shares of itself, it's not required to file insider reports*) (***NI 55-104 Part 7***); **mutual funds** (***NI 55-104 s. 9.1***). But generally, exemptions to insider reporting requirements are pretty rare; most people don't fall under them.

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:** (1) Insider Bids; (2) Issuer Bids; (3) Business Combinations; (4) Related Party Transactions. It provides enhanced protection for minority shareholders with **extra rules for:** (1) enhanced disclosure, (2) formal valuation, (3) minority approval.

Note: ***MI 61-101*** is an Ontario rule (copied in Quebec), but *not copied anywhere else*. BUT because **it has been ratified by the TSX**, most companies have to comply with it whether their home Sec Com thinks it is appropriate or not. So first, find out if the transaction in question fits within these rules.

MI 61-101 PROTECTION OF MINORITY SECURITY HOLDERS IN SPECIAL TRANSACTIONS

Part 1: DEFINITIONS

"**business combination**" (*i.e. going private transaction*): basically, a transaction in which one shareholder will become 100% owner of the company and other shareholders will be expropriated from their shareholding position in the company, it is a going-private transaction/business combination. *So you're looking for one shareholder to stay and everyone else being screwed* (***MI 61-101 s. 1.1***).

"**collateral benefit**": a benefit that is being conferred on one party/shareholder that is not being conferred on everybody. It is an attempt to give somebody higher value than is being offered to other people. *Note:* some benefits are not collateral benefits (*ex. enhancement of employee benefits*) (***MI 61-101 s. 1.1***).

"**connected transactions**" (*i.e. second stage transaction*): two transactions that have at least one party in common, and (a) are negotiated or completed at approximately the same time, or (b) the completion of one of the transactions is conditional on the completion of the other transaction (***MI 61-101 s. 1.1***). ***Sears Canada*** *was an example of this: it was Sears Holdings intention, if they captured ⅔ of the vote to vote those shares at the shareholders' meeting to cause the company to go private.*

"**independent committee**": a committee consisting exclusively of one or more independent directors (***s. 1.1***).

"**independent director**": a director who is independent as determined in s***. 7.1*** (***s. 1.1***).

"**independent valuator**": a valuator that is independent of all interested parties in the transaction, as determined in ***s. 6.1*** (***s. 1.1***).

"**insider bid**": a takeover bid made by (a) an "**issuer insider**" of the target company *i.e.*: director or senior officer of the target, holder of more than 10% of voting rights (whether through beneficial ownership of, or control or direction over, directly or indirectly), director or senior officer of the 10% shareholder, or director or senior officer of a subsidiary entity of the target; (b) an **associated or affiliated** entity of the target; (c) an **associated or affiliated** entity of an "issuer insider" of the target; (d) any of the persons above, for the **12 months before commencement of the bid**; (e) a **joint actor** with any person above (***s. 1.1***).

"**market capitalization**": basically: *number of shares outstanding* x *value of shares = market capitalization. Ex. 10 million shares at $10 each = $100 million market capitalization* (***s. 1.1***).

"**minority approval**": for a business combination or related party transaction of an issuer, approval of the proposed transaction by a **majority of the votes as specified in *Part 8***, cast by holders of each class of **affected securities** at a meeting of security holders of that class called to consider the transaction;

"**related party**": a person (*other than a person that is solely a bona fide lender*) that, at the relevant time and after reasonable inquiry, is **known by the entity or a director or senior officer of the entity** to be: (a) a control person (20% shareholder) of the entity, (b) any company of which that control person of this entity is also a control person, (c) any company, which this entity is a control person of, (d) a person with more than 10% of the voting rights (whether through beneficial ownership of, or control or direction over, directly or indirectly), (e) a director or senior officer of the entity or any other company described above, (f) a person that manages or directs, to any substantial degree, the affairs or operations of the entity, (g) any company in which the people described above own, in the aggregate, more than 50% of the securities of any outstanding class of equity securities, or (h) an affiliated entity of any of the above (***MI 61-101 s. 1.1***).

***Part 2*: INSIDER BIDS**

"**insider bid**": a takeover bid made by (a) an "**issuer insider**" of the target company *i.e.*: director or senior officer of the target, holder of more than 10% of voting rights (whether through beneficial ownership of, or control or direction over, directly or indirectly), director or senior officer of the 10% shareholder, or director or senior officer of a subsidiary entity of the target; (b) an **associated or affiliated** entity of the target; (c) an **associated or affiliated** entity of an "issuer insider" of the target; (d) any of the persons above, for the **12 months before commencement of the bid**; (e) a **joint actor** with any person above (***s. 1.1***).

(1) Enhanced disclosure: In addition to the disclosure requirements in MI 62-104, the **offeror must disclose:** (a) background to the insider bid; (b) all prior valuations of the target company made within 24 months prior to the bid, (c) formal valuation or exemption, if any (***MI 61-101 s. 2.2(1)***).

The Board of the target must disclose: (a) all prior valuations that *they* are aware of within 24 months prior to the bid; (b) background to the insider bid; (c) any prior offer they have received within 24 months prior to the insider bid; (d) the review and approval process adopted by the Board and the Special Committee, if there is one, in support of the Board's recommendations as to whether shareholders should accept or reject the bid (***MI 61-101 s. 2.2(2)***).

(2) Formal valuation: The **offeror is required to provide:** (a) a formal valuation, at its own expense; (b) disclosure regarding the valuator (in compliance with ***s. 6.2***); (c) a summary of the formal valuation (in compliance with ***s. 6.5***); and generally comply with the requirements of ***Part 6 re formal valuations*** (***MI 61-101 s. 2.3(1)***).

An independent committee of the target shall: (a) determine who the valuator will be; (b) supervise the preparation of the formal valuation; and (c) use its best efforts to ensure that it is completed and provided to the offeror in a timely manner (***MI 61-101 s. 2.3(2)***). *Rationale:* the valuation produced by an independent valuator who is compensated as an independent valuator and overseen by the independent committee is capable of coming up with a valuation that is not influenced by the insider who is making the insider bid.

Sears Canada: *Sears Holdings became frustrated with Board of Sears Canada. They waited 60 days and there was no valuation, so they went to Sec Com to get an order relieving them of the obligation to include a formal valuation. This didn't work, but it does represent a delay in the process because valuations take some time.*

(3) Exemptions from Formal Valuation Requirement:

(1)(a): Lack of Knowledge and Representation: If you have no inside knowledge and nobody representing you has been on the Board for at least 12 months prior to the date of the insider bid, you can say, "look I don't have any special information that other people don't have," and therefore you don't have to comply with the valuation requirement (***s. 2.4(1)(a)***). *Question is: Who is on the Board? Do you have anyone nominated on the Board? Do you receive information from the company from that nominee? If you're a shareholder that qualifies because you hold 10% but have no insider information, you may be able to escape having to have a valuation.*

(1)(b): Prior Arm's Length Negotiation: prior transaction with a large shareholding position who would have provided an informed value; has to meet 7 conditions (***s. 2.4(1)(b)***). The general idea is: *if I'm a large shareholder in a company and I negotiate a price with a 20% shareholder in the company, that represents fair value, given the sophistication of that shareholder. So if you make an offer that's at that price to everybody, you don't have to do a valuation, you can just point to that third party negotiation that you did.*

(1)(c): Auction: Three conditions: (a) the bid is publicly announced, (b) that there is equal access to information, and (c) that there is adequate disclosure (***s. 2.4(1)(c)***). *Basically:* if there is an auction/bid underway for the target company, you can use the fact that a third party is trying to make a bid as the valuation metric. Provided that it is widely known that there is that takeover bid underway, you don't need to include a valuation with your insider bid. ***WIC:*** *CanWest, a 35% shareholder, was making a bid for all the shares that it didn't own. Management and Board encouraged a shareholder of the company, Shaw, to make a bid in competition with CanWest. Shaw didn't have to get a formal valuation.*

Part 3: **ISSUER BIDS – NOT ON EXAM (BC RULES ARE SUFFICIENT)**

Part 4: **BUSINESS COMBINATIONS (I.E. GOING PRIVATE TRANSACTIONS)**

"**business combination**" (*i.e. going private transaction*): basically, a transaction in which one shareholder will become 100% owner of the company and other shareholders will be expropriated from their shareholding position in the company, it is a going-private transaction/business combination. *So you're looking for one shareholder to stay and everyone else being screwed* (***MI 61-101 s. 1.1***).

(1) Enhanced disclosure (Meeting and IC): The issuer proposing the combination must call a meeting of shareholders of all securities that will be affected and send out an information circular which includes: (a) the standard disclosure as per MI 62-104, (b) background of the business combination, (c) all prior valuations and bona fide offers within the last 24 months, (d) review and approval process by the Board and any Special Committee, (e) any dissent opinions and material disagreement between the Board and the Special Committee, (f) any subsequent material changes (***MI 61-101 s. 4.2(3)***).

(2) Formal valuation: If an interested party would, as a consequence of the transaction, acquire or combine with the issuer through amalgamation or arrangement, then the issuer shall obtain a formal valuation (***MI 61-101 s. 4.3(1)***). If a formal valuation is required, the **offeror is required to provide:** (a) a formal valuation, stating in its disclosure document who will pay for the valuation; (b) disclosure regarding the valuator (in compliance with ***s. 6.2***); (c) a summary of the formal valuation (in compliance with ***s. 6.5***); and generally comply with the requirements of ***Part 6 re formal valuations*** (***MI 61-101 s. 4.3(2)***).

An independent committee of the target shall: (a) determine who the valuator will be; and (b) supervise the preparation of the formal valuation (***MI 61-101 s. 4.3(3)***).

(3) Exemptions from Formal Valuation Requirement:
(1)(a): Issuer Not Listed on Specified Markets: no securities of the issuer is listed on TSX, NYSE, ASX, NASDAQ, or a stock exchange outside of Canada and the United States (***s. 4.4(1)(a)***).
(1)(b): Prior Arm's Length Negotiation: prior transaction with a large shareholding position who would have provided an informed value; has to meet 7 conditions (***s. 4.4(1)(b)***).
(1)(c): Auction: Three conditions: (a) the bid is publicly announced, (b) that there is equal access to information, and (c) that there is adequate disclosure (***s. 4.4(1)(c)***). *Basically:* if there is an auction/bid underway for the target company, you can use the fact that a third party is trying to make a bid as the valuation metric. Provided that it is widely known that there is that takeover bid underway, you don't need to include a valuation with your insider bid.
(1)(d): Second Step Business Combination: **4 conditions:** (a) the combination is effected by the offeror that made a bid and deals with shares that were not acquired in that bid, (b) the combination is completed within 120 days after expiry date of the bid, (c) the price per share that SHs would get here is equal or more than the previous bid price, (d) the offeror's intention to do this and the tax consequences are stated in disclosure document for the bid (***s. 4.4(1)(d)***). SO for a second step business combination, you don't have to include a formal valuation because your bid *is* the valuation. ***Sears Canada*** *was an example of this: it was Sears Holdings intention, if they captured ⅔ of the vote to vote those shares at the shareholders' meeting to cause the company to go private.*

(4) Minority approval: Minority approval for the business combination is required, in compliance with ***Part 8 re minority approval*** (***MI 61-101 s. 4.5***).

(5) Exemptions from Minority Approval Requirement: *very limited.*
(1)(a): 90% Exemption: If one or more interested parties beneficially own, in the aggregate, 90% or more the of outstanding securities of a class of affected securities at the time the combination is agreed to, and either (a) an appraisal remedy is available to affected shareholders equivalent to CBCA s. 190, or (b) the affected shareholders are given an enforceable right that is substantially equivalent to the appraisal remedy, and this is described in the disclosure document for the combination (***MI 61-101 s. 4.6(1)(a)***). 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 (***MI 61-101 s. 4.6(2)***).
(1)(b): Amalgamation or Equivalent Transaction with No Adverse Effect on Issuer or Minority (***s 4.4(1)(f)***).

***Part 5*: RELATED PARTY TRANSACTIONS**

"**related party**": a person (*other than a person that is solely a bona fide lender*) that, at the relevant time and after reasonable inquiry, is **known by the entity or a director or senior officer of the entity** to be: (a) a control person (20% shareholder) of the entity, (b) any company of which that control person of this entity is also a control person, (c) any company, which this entity is a control person of, (d) a person with more than 10% of the voting rights (whether through beneficial ownership of, or control or direction over, directly or indirectly), (e) a director or senior officer of the entity or any other company described above, (f) a person that manages or directs, to any substantial degree, the affairs or operations of the entity (*excluding a person acting under bankruptcy or insolvency law*), (g) any company in which the people described above own, in the aggregate, more than 50% of the securities of any outstanding class of equity securities, or (h) an affiliated entity of any of the above (***MI 61-101 s. 1.1***).

"**related party transaction**" (*very broad range; casting a wide net*): a transaction between the issuer and a related party of the issuer at the time the transaction is agreed to, as a consequence of which, either through the transaction itself or together with connected transactions, **the issuer directly or indirectly**: (a) purchases or acquires an asset from the related party for valuable consideration, (b) purchases or acquires, as a joint actor with the related party, an asset from a third party if the proportion of the asset acquired by the issuer is less than the proportion of the consideration paid by the issuer (*company gets less than paid for*), (c) sells, transfers or disposes of an asset to the related party, (d) sells, transfers or disposes of, as a joint actor with the related party, an asset to a third party if the proportion of the consideration received by the issuer is less than the proportion of the asset sold, transferred or disposed of by the issuer (*company gets less for its asset*), (e) leases property to or from the related party, (f) acquires the related party, or combines with the related party, through an amalgamation, arrangement or otherwise, whether alone or with joint actors, (g) issues a security to the related party or subscribes for a security of the related party (*security exchange with the related party*), (h) amends 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 related party, or agrees to the amendment of the terms of a security of the related party if the security is beneficially owned by the issuer or is one over which the issuer exercises control or direction (*change of security terms for related party*), (i) assumes a liability of the related party, (j) borrows or lends money to the related party, or enters into a credit facility with the related party, (k) releases, cancels or forgives a debt or liability owed by the related party, (l) materially amends the terms of an outstanding debt or liability owed by or to the related party, or the terms of an outstanding credit facility with the related party, or (m) provides a guarantee or collateral security for a debt or liability of the related party, or materially amends the terms of the guarantee or security (***s. 1.1***).

This part does not apply to an issuer carrying out a related party transaction if: (a) the issuer is not a reporting issuer, (b) less than 2% of shareholders are in the local jurisdiction, and all documents concerning the transaction were sent to the shareholders, (c) it's a downstream transaction (parent to subco), (d) it is a business combination of the issuer, (e) the transaction is between the issuer and a wholly-owned subsidiary or between sister subsidiaries of the same issuer, and a few more esoteric ones (***MI 61-101 s. 5.1***).

"**market capitalization**": basically: *number of shares outstanding* x *value of shares = market capitalization. Ex. 10 million shares at $10 each = $100 million market capitalization* (***s. 1.1***).

(1) Material change report: Whether or not the transaction otherwise qualifies as something that requires a material change report, if its a related party transaction, it absolutely does. Things to include in your material change report: (a) description and material terms of the deal, (b) business reasons for the deal, (c) effect of deal on business affairs, (d) description of the interest of related party, (e) anticipated effect on percentage of securities it holds, (f) review and approval process adopted by the Board/special committee, (g) prior valuations over last 24 months, (h) summary of formal valuation, (i) exemptions relied on (***MI 61-101 s. 5.2***).

If the transaction exceeds 25% of market capitalization, in addition to a material change report, you are required to: (a) hold a meeting and send out an information circular with enhanced disclosure, (b) get a formal valuation, and (c) get minority approval. See next page.

(2) <u>Enhanced disclosure</u> (**Meeting and IC**): Issuer must call a meeting of shareholders of all securities that will be affected and send out an IC that includes a whole bunch of crap, similar to s. 5.2 (***MI 61-101 s. 5.3***). This section applies only if minority shareholder approval is required under s. 5.6.

(3) <u>Formal valuation</u>: An issuer shall obtain a formal valuation for a related party transaction described in (a)–(g) of the definition of related party transaction.

The **offeror is required to provide:** (a) a formal valuation, stating in its disclosure document who will pay for the valuation; (b) disclosure regarding the valuator (in compliance with ***s. 6.2***); (c) a summary of the formal valuation (in compliance with ***s. 6.5***); and generally comply with the requirements of ***Part 6 re formal valuations*** (***MI 61-101 s. 5.4(2)***).

An independent committee of the target shall: (a) <u>determine who the valuator will be</u>; and (b) <u>supervise the preparation</u> of the formal valuation (***s. 5.4(3)***).

(4) <u>Exemptions from Formal Valuation Requirement</u>:
(a): <u>FMV Not More Than 25% Market Capitalization</u>: Where the FMV of the transaction (or the FMV of consideration) is not more than the 25% of the market capitalization of the company at the time the transaction is agreed to. (a) If either FMVs is not readily determinable, any determination of value by Board has to be made in good faith. (b) If the issuer (or its wholly-owned subsidiary) is combining with a related party, the subject matter of the transaction shall be deemed to be the securities of the related party 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 related party's shares acquired that issuer did not have before*]. (c) 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. (d) If the assets involved in the transaction include warrants, options, etc, the calculation of the FMV for the initial transaction shall include the FMV, as of the time the initial transaction is agreed to, of the maximum number of securities or other consideration that the issuer may be required to issue or pay in the future transaction (***MI 61-101 s. 5.5(a)***). **The only important one.**

(5) <u>Minority approval</u>: Minority approval is required, in compliance with ***Part 8 re minority approval*** unless it fits into an exemption below (*i.e. FMV not more than 25% of market cap*) (***MI 61-101 s. 5.6***).

(6) <u>Exemptions from Minority Approval Requirement</u>:
(1)(a): <u>FMV Not More Than 25% Market Capitalization</u>: Where the FMV of the transaction (or the FMV of consideration) is not more than the 25% of the market capitalization of the company at the time the transaction is agreed to (***MI 61-101 s. 5.7(1)(a)***).
(1)(b): <u>FMV Not More Than $2.5 million</u>: If the FMV of the transaction is not more than $2.5 million, then you don't need minority approval (*intended to cover small transactions*) (***MI 61-101 s. 5.7(1)(b)***).

Part 6: FORMAL VALUATION AND PRIOR VALUATIONS

There is an attempt here on the part of ON Sec Com to identify the types of situations where somebody is really not eligible to provide a valuation: (1) **There is a relationship with the issuer** (they're your bank/ auditor/someone who you're already getting paid by the company); (2) If the **compensation for the valuator is contingent on the completion of the transaction** that is being pursued, or there is some incentive that the valuator gets as a result of the positive conclusion of that transaction, then the person is not independent, they have an interest in the success of the transaction and therefore lose their position as somebody who could be a valuator (***MI 61-101 s. 6.1(3)***).

Once you've determined that the person is independent, there is disclosure about the evaluator (***s. 6.2***): what is their experience, their interest in the transaction, what's the subject matter of the formal valuation (***s. 6.3***). It's outlined what they need to do in order to prepare the valuation (***s. 6.4***). If you do a formal valuation, a summary is required (***s. 6.5***). Disclosure of prior valuations (in past 24 months) is also required (***s. 6.8***).

Part 7: INDEPENDENT DIRECTORS

It is a question of fact whether a director of an issuer is independent. **One is not an independent director if the director is:** (a) an interested party in the transaction, (b) was in the last 12 month, an employee, associated entity or issuer insider of an interested party (or its affiliate), (c) was in the last 12 month an adviser (or its employee, associated entity or issuer insider) to an interested party of the transaction, (d) has a material financial interest in an interested party (or its affiliate), (e) would reasonably be expected to receive a benefit due to the transaction that is not also available to other shareholders (***MI 61-101 s. 7.1(2)***).

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 (***s. 7.1(3)***).

Part 8: MINORITY APPROVAL

"**minority approval**": for a business combination or related party transaction of an issuer, approval of the proposed transaction by a **majority of the votes as specified in** ***Part 8***, cast by holders of each class of **affected securities** at a meeting of security holders of that class called to consider the transaction;

Generally: Minority Approval is required for a business combination or related party transaction, involving all shareholders 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: (a) the issuer, (b) an interested party, (c) a related party of an interested party, or (d) a joint actor with any of the above (***MI 61-101 s. 8.1***).

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 (a) shareholders that tendered the securities to the bid were not joint actors with the offeror, (b) shareholders 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, (c) the business combination is for the same class of securities the bid was made to and not acquired in the bid, (d) the business combination is completed less than 120 days after the expiry date of the bid, (e) the consideration per share now is more or equal to the consideration the tendering shareholders were entitled to receive in the bid, and (f) disclosure document meets certain requirements (*that I can't be bothered to copy here*) (***MI 61-101 s. 8.2***).

Part 9: EXEMPTIONS

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.

APPENDIX A: TOOLS

EXAM CHEAT SHEET

Question 1: 60% 115 minutes
30 minutes to read / 85 minutes to answer: 10 minutes/issue (1 page) = 8 issues

Question 2: 40% 75 minutes
20 minutes to read / 55 minutes to answer: 10 minutes/issue (1 page) = 5 issues

First, quick spot: (1) companies involved (parent/subco) (2) the takeover bid (3) the defences (white knight) (4) read final paragraph instructions. Then, go back and start reading identifying issues in each paragraph.

Share structure of companies: figure out percentages

Company *X*:	Total 1,000,000 c/s	Company *Y*:	Total 1,000,000 c/s
Parent?	10% = 100,000 c/s	Subco?	10% = 100,000 c/s
	20% = 200,000 c/s		20% = 200,000 c/s
	Price: $10 (2012)		Price: $10 (2012)
	Market cap = $10,000,000		Market cap = $10,000,000
	TSX? Yes		TSX? Yes
S/H's:	Insiders (10%)? Control (10%)?	S/H's:	Insiders? Control?
	10% Person *X*		10% Person *X*
	10% Person *X*		10% Person *X*
	10% Person *X*		10% Person *X*
Board:	Conflicts? **	Board:	Conflicts? **
	Person X		Person Y
	Person X		Person Y
	Person X		Person Y

Takeover bid: write down the terms, then write down terms of specific deals and compare

TOB:	Announced: April 13, 2013		
	Total: 1,000,000 c/s = 100%		
	Price: $15/share = 50% premium (norm: 20–40%)		
Lock-up?	Total: 600,000 c/s (60%)		
	1. Person X	2. Person Y	3. Person Z
Side Agmts:	Collateral benefit? Higher price? Side deal?		
	1. Person X:	2. Person Y:	3. Person Z:

Defensive tactic: write down the terms of any agreements, and competing bid offer made

Support Agmt:	Break fee? 5% (norm: 2–4%)
	Asset option? Crown jewel? At FMV?
	Share option?
	Anything else?
Offer:	Announced: April 23, 2013 (10 days after TOB)
	Total: 1,000,000 c/s = 100%
	Price: $25/share

Share purchases: Did they go over 10%? Did they go over 20%?

ISSUE SPOTTING

Anyone with **10% voting rights** (*Parent Co, D&O of 10% holder, joint actor*) is an **insider** and a **related party**. If they make a **bid**, this triggers (1) insider bid rules. If they enter into a **transaction**, this triggers (1) insider report (*if for shares*) (2) related party rules (*if for assets/etc*) (*also for 20% s/h*) (*unless <25% market cap*).

If bidder is working with or being given information by management of the target, they may be an insider bidder.

Anytime someone buys shares: Did they go over **10%**? This triggers: (1) early warning report (2) insider report (*initial/subsequent*). Did they go over **20%**? This triggers (1) takeover bid rules or (2) exemptions.

If there is a **relationship with a bank** and they provide advice, they may not be an **independent valuator** (for purposes of formal valuation pursuant to an insider bid/business combo/related party transaction).

If someone **resigns from a Board**: think about the **12-month period** rule (for purposes of insider bid/ exemption from formal valuation for insider bidder/independence of director, they have to wait 12 months).

If there is a **major development**: Was it a **material fact**? Did it amount to a **material change**? If so, it would have had to be disclosed. Did anyone **trade/tip** based on this information? If so, insider trading rules apply.

If someone receives **confidential information** and **trades on it** or **discloses it** and that person trades on it, insider trading/tipping rules apply. **NB:** Are there **defences** that apply? Note: **liability** and **standard of proof**.

If someone is **buying shares through someone else**, they are **acting jointly or in concert**, so you aggregate their holdings: Did they go over **10%**? This triggers: (1) early warning report (2) insider report (*initial/ subsequent*). Did they go over **20%**? This triggers takeover bid rules.

If there is a **special side deal in a takeover bid**: Is it a **collateral benefit**? Are they being paid a higher premium than the other shareholders (*all-holders best price rule*)? See price/consideration.

If some **major development or information** comes to light *after a takeover bid*, it is **material information** and has to be **disclosed** (Notice of Change to Directors' Circular/TOB Circular).

If there is a **support agreement** (white knight): Is the **break fee** reasonable (2–4%)? If there is an **asset option**: Is it a crown-jewel defence? Is it being offered below FMV? If there is a **share option**: identify Fibrek: *you can't issue shares, the result of which is to dilute the shareholding interest of the parties who are in lock-up.* **In total:** when it looks like you are shifting the balance too much in favour of the white knight, the normal business judgment rule that you would expect might not be honored (defensive tactics and board's duties).

If you see extra value in a company you're acquiring: There is an **obligation on an offeror** to disclose if he **sees more value** in target, which the target has missed (*surplus surplus* case). See Disclosure Requirements.

If there is an **acquisition being made**: Does the company have a **disclosure obligation** while a deal is being negotiated (early stages: probably not; later stages: yes)? It is a material fact, it might amount to a material change. See email.

If there are "**non-voting common shares**": you can't have anything other than "common shares" according to TSX Rules (see Restricted Voting Securities). **Restricted securities**? See TSX Rules.

Pre-bid integration rules: If an offeror purchased shares 90 days prior to a TOB, he must offer the highest price paid and acquire highest percentage acquired in that previous transactions (See Pre-Bid Considerations)

Second step business combination (going private): you need minority approval to do a business combination.

Look out for: Directors who are not acting in their own best interest (especially if they are shareholders and are trying to avoid diluting themselves).

If **Board members are not invited** to a Board meeting: You have to invite all the Board members. Whether or not they appear to have a conflict of interest, they are entitled to be notified of a meeting. At the meeting, you might determine that there is a need for the independent directors to convene separately.

These transactions represent a violation of securities laws, exposing the individuals who were engaged in these trades and the issuer itself to potential fines and penalties, including the possibility of an order for divestiture of the securities that were acquired. Advice to Board: Attack transactions listed above and any securities bought with the benefit of insider information. Go after people for insider trading/tipping, try to effectively frustrate the bid for failure to disclose and securities breaches. You may have to redo Support Agreement and withdraw things that might be problematic but still try to provide white knight with a Support Agreement that would encourage a bid.

SOME KEY CONCEPTS

OSC decisions are not strictly binding on BC Sec Com but they are found to be incredibly informative. The OSC is the largest and busiest Commission in Canada, and is seen to be the one with the deepest well of expertise (and we like to **defer to expertise**). Also: rules in BC and ON are typically identical so the same principle would likely apply in BC .

Courts give immense deference to Commissions (***Canadian Tire Corp***).

Early warning report: After disclosure of 10% (or 5% in the face of a bid), for every 2% increment above that initial level, a new report has to go out – so early warning reports happen at 10% and every 2% thereafter. If you're below 20% but above 10%, every time you do a report, you have to step out of the market for at least 1 clear trading day. This is to allow the disclosure of the fact that you're accumulating to get disseminated in the market. When you get to 20% that cooling off period no longer applies.

Insider report:

Private agreement exemption: as long as you buy from NO MORE than 5 shareholders for no more than 115% of the market price, its not a takeover bid. The rule works on a **20-day volume-weighted average price:** you look at *how much was sold at each price, not just at the price it was sold at.* Nobody sells control or anything really mildly valuable for 115% so if what you're selling is only getting 115% of the market price and it is a true arm's length trade, and you are actually valuing in all the considerations (side-deals/collateral benefits), these 5 investors aren't selling anything that is really valuable so this should be okay.

Takeover bid:
- Day 1: announcement, has to stay open for 35 days
- Day 15: target company has to file a Directors' Circular in response (CA: US: 14d-9)
- Every time there is a material change in the facts underlying the Circular, you have to file an amendment
- 7 days before expiry of bid: final recommendation (if no recommendation given)

Pre-bid integration rules: If your goal is to get 100% of the target company, one of the things you have to worry about is that your toe-hold may not count for purposes of the vote to squeeze out the minority. The shares you held prior to your bid transaction cannot be counted in the vote of whether your transaction is approved by a majority of the shareholders. But the larger toe-hold you have, the less competing securities there are.

Lock-up Agreements: Hard vs. soft lock-up agreements: soft is where you agree to tender the shares into my offer but if another offer comes along, you can withdraw from that commitment and tender to the better bid. Hard: you agree to tender your shares into my offer and you can't get them back.

All-holders/best price rule: The only protection you have built into the takeover bid rules as a small, voting common shareholder. If A is making an offer for 20% or more of a class of voting securities, they have to offer all holders of that class of securities the same best price. This rule makes sure that the control premium (the amount you pay above the trade price to get control) is shared with the little guys.

Minimum tender condition: How many shares have to be tendered to your offer before you're actually going to go ahead and take the securities – typically, it's 66⅔%.

Minimum tender conditions are coercive: *I make a bid for 100% of the company and it is a condition of my offer that a ⅔ majority of the shares are tendered. Because I want the ability to effect a second-stage squeeze out transaction to take the company private afterwards (special resolution). What if in the process of my offer, I change my bid to provide that it is going to close on March 5 and I'm going to eliminate my minimum tender condition and I'm only going to take up the shares that are tendered to me at that time. What you've effectively done is change the dynamic between yourself and the shareholders. Any shareholder who tenders is assured*

they're going to have their shares taken up (because there is no minimum condition) and anyone who resists runs the risk that their shares won't be bought at that premium. So you don't know if the bidder is going to do the second-stage transaction – you could end up finding yourself in a minority in the company with no premium left. So there is a theory in Canada that a takeover that includes a minimum condition (⅔ type) – a removal of that ⅔ minimum tender condition in the offer represents a form of coercion.

Parial bids are coercive: *If I make a bid for a company, I'm 13% I make a bid for 37% – I just want control of the company. You're a shareholder, the bid is expiring, what do you do? You tender, because if you don't, you'll probably never get the takeover premium because the stock value is going to fall off if he has control, that's why he wants the control. So if you're ever going to participate in a share premium attached to a change of control of the company, it's in the initial bid.*

Coattail provisions: Coattails are a specific agreement that is entered into between the controlling C/S-holders and the group of Class A shareholders – it says, if you buy class A shares, you get, along with that, the benefit of a coattail provision.

Crown-jewel defence: If they think someone is just coming in to just get one bit of their enterprise (because they have misallocated value to it), then if you can sell that bit to someone else, then the whole deal will go away because there is no reason for them to buy you anymore

White knight defence: when you go out and find an alternate acquirer.

Poison pills (SRP): *Essentially what it says is:* if anybody acquires more than *x* percentage of this company in a deal that wasn't recommended by the Board of Directors, on the day after they are required by securities laws to pay for your securities, everybody, before they tender to this guy, is going to get 3 shares for every 1 share that they have. This guy just made an offer to acquire the company for full price is going to end up with ¼ of it. So the poison pill is a mechanism that makes it impossible for the offeror to get the benefit of their bargain.

BUT in Canada, directors do not have the power to just say no. The Securities Commissions have said that part of the fundamental right of shareholders is the ability to determine when they are going to sell, and the Board can't take that choice away from them. **As a result, roughly 60 days after a bid has been *announced*, if a competitive situation hasn't emerged**, then if the target has put a poison pill in place, the securities commissions will cease trade it. The pill is for the company to slow things down and give the Board the opportunity to find somebody else who is willing to offer a better price, or other defence tactics. But eventually the pill must go – and that's roughly 60 days

Usually, if you receive a **bear hug offer** (4pm on a Friday afternoon), it is opportunistic – it's because something bad has happened in the past few months and you're at a low price. Remember: typical takeover premium is 35% so if your share price is off by 40%, you can offer to buy that company at 95% and still be within the 35% takeover bid premium.

Entrenchment: actions that are taken by the existing management of a corporation that are designed to preserve management's control of the corporation at the expense of the shareholders.

Upside protection: If I, in a certain amount of time, sell your shares to somebody else, I'll give you the upside or I'll split it with you or something.

Insider trading rules have 2 parts: (1) Insider trading: when you hear some sort of confidential information about the company that isn't known to the public and you go out and buy yourself securities on the basis of that information and you make a lot of money, (2) Tipping: you work for the company and you tell confidential information to somebody else, if that person goes off and trades on it, you're just as liable as they are.

Under TSX rules, you can't have "**non-voting common shares**." This is to avoid confusion: common shares are shares that have 1 vote per share and have a pro-rata participation in the economics. Similarly, you can't use "preference" or "preferred" in the name of a security unless a non-specious preference is granted – something that actually is a preference.

"**as amended from time to time**" is an important drafting convention put into agreements – if you don't have it after a reference to a statute or any other kind of third party document, you're arguably saying that it's the Securities Act as it existed as of the date of this agreement. *Example: if you reference GAAP without saying "as amended from time to time," you don't pick up IFRS – if you don't define GAAP as "the accounting principles that are generally accepted in Canada as approved by the Canadian Institute for Chartered Accountants" then you don't pick up IFRS.*

If you come up against a **plan of arrangement**, go to *BCE* and *Magna International* decisions.

When you see a financing deal on a *best-efforts basis*, that's an **agency deal** – the agent is saying we will do our best efforts to sell these shares. We're going to enter into this agency agreement, we're going to sell $100 million worth of shares. If they succeed, great. If they don't, there is no liability (other than reputation). An underwriting agreement is what they call a **bought-deal** – the underwriters have committed to buy the $100 million in shares from the company on the closing date. If they don't have purchasers, the underwriters are on the hook for it.

APPENDIX B: CASES AND STATUTORY PROVISIONS

INTERMEDIARIES IN THE CAPITAL MARKETS

***In the Matter of George C Kern Jr (Allied Stores Corporation)* US SEC 1988**

- Campeau Corporation was an inquisitive participant in the capital markets in Canada
- Kern (partner at Sullivan & Cromwell – law firm in NY) was alleged to have *caused* his client to fail afoul of **Rule 14d-9** (US – 14d-9 is US's takeover rules)
- Campeau corporation had made a bid to acquire Allied Stores
- Kern was retained as counsel for Allied
- He strayed
- There is a fundamental rule that many lawyers breach – **lawyers advise, clients act – lawyers don't act! (unless they have instructions from client to act as agent)**
- Kern acted as if he was in charge
- He took responsibility to advise on when disclosure filings were needed
- **Here, Campeau made the offer so Allied was required under US securities law to file a 14d-9 in response – the exact same rule applies in Canada:**
  - **Takeover bid is filed in Canada**
  - **The target company has 15 days to file a Director's Circular in response**
- **Another rule that applies: every time there is a material change in the facts that underly the circular, you have to file an amendment**
- Kern went out and met with a potential crown jewel buyer
    - **NB: Crown-jewel buyer:**
      - **Crown jewel defence is one of the defences for a takeover bid**
        - **If they think someone is just coming in to just get one bit of their enterprise (because they have misallocated value to it), then if you can sell that bit to someone else, then the whole deal will go away because there is no reason for them to buy you anymore**
      - Deal between A and T is a friendly deal – this isn't what was happening in this case
        - In this case, Campeau wanted to buy but Allied didn't want to sell, at least not to Campeau (hostile takeover)
        - Kern was defending against this hostile takeover – he went and talked to a crown jewel buyer – EJDC
        - EJDC offered to buy the crown jewel for $405 million
        - Kern was later told by someone at Allied that that price was acceptable
        - Kern determined that no filing was required – the SEC disagreed
        - ***Remember: they had a 14d-9 on file – the rule for 14d-9 is the same as the rule with a director's circular – if there is a material change in the facts, then you have to disclose***
        - **Why? Because the marketplace needs to make up its mind as to whether or not to tender to the takeover bid**
        - They were required to disclose the material change

    - **White knight defence:**
      - Another defence: when you go out and find an alternate acquirer

- Eventually, the SEC kind of threw up their hands – lawyers aren't the ones who are supposed to be making the decisions about whether or not something is a material change – that's the client job
- Lawyers advise, clients act – the client should have been making the decision about whether or not to file an amendment to the 14d-9 filing
- Of course, they don't know the rules – that's the lawyer's job – to tell them
- Kern, by being the one who acted, ended up in this weird situation where he couldn't even be punished for what he was doing

- What they wanted to do was put an order in place to stop doing what he was doing but how do you tell him to stop doing what he wasn't even supposed to be doing?

- **This case is a good case because:**
  - **It talks about the analysis you have to go through when determining whether or not something is a material change (so that you need to file an amendment to your existing disclosure)**
  - **It talks about the fact that lawyers, as intermediaries in the marketplace, are in this strange and somewhat privileged position because they are participants in the marketplace, but they are not really participants that are highly regulated, unlike everybody else**

THE ROLE OF THE BC SECURITIES COMMISSION

***In the Matter of Canadian Tire Corporation, Limited et al* 1987 ON**

- Canadian Tire ended up doing a whole bunch of stuff that we talked about in the last 2 classes
- CT had an owner that owned 30.9% of CT
- This guy dies and Billes family bought from the estate of this dude the 30.9%
- After they do that, they realize that it's a bigger nut than they can chew, and they need to sell a part of it off – they were borrowing to pay for this – they had to sell a chunk of what they bought to pay down their acquisition costs
- But they didn't want to lose control
- So they end up holding 60.9% of the company? And they want to finance that acuisition but they don't want to lose the control they have
- So they want to induce investors to give them some money without giving up control
- So they create class A non-voting shares

- CT:
  - Common shares
    - Billes owns 60.9% of these
  - Class A shares
    - Public owns these

- Problem with class A non voting shares
  - While you participate in the economics, you don't participate in the running of the company
  - This makes people nervous because they're exposed to the Billeses entering into transactions that favour themselves
  - To protect the investors, to make sure they don't get screwed, they get <u>**coattails provisions**</u>
  - **Coattails** are a specific agreement that is entered into between the controlling C/S-holders and the group of Class A shareholders – it says, if you buy class A shares, you get, along with that, the benefit of a coattail provision
    - The coattails said: if an offer is made to purchase securities of Canadian Tire and a majority of the common shareholders tender to the offer, then the class A non-voting shares receive the right to vote on that transaction – so they do get to vote in this special circumstance
    - And there were a lot more of the Class A shareholders than the common shareholders – at the end of the day it was something like 95% of the economics was with Class A
    - So if the Class A's got to vote on something, they would win the vote
    - <u>**But**</u> you don't get to vote if the offer is made to acquire <u>both</u> the common shares AND the class A non-voting shares at the same price, on the same conditions, and no distinguishment between the two classes – there can't be anything in the offer that distinguishes between the classes

    - The idea being: wrapping up the voting power so that it essentially puts you in the same kind of position as you would be in if you were a small voting common shareholder

    - As a small voting common shareholder, the only protection you have is built into the takeover bid rules – <u>**all holders/best price rule**</u>

- If you're making an offer for 20% or more of a class of voting securities, you have to give all holders the same best price
- Give the offer to all holders and the best price you give to any of them is the price you have to give to all of them – IF YOU ARE BUYING MORE THAN 20%
  - Idea is: it's not fair that people who have the control block can sell and buy control of the corporation and they never have to involve the minority if they don't want
  - Because if you own 67% of the common shares of a company, you can just buy and sell that block and the remaining minority will never have the opportunity to take part in this sale
  - Because at 67% you can pass special resolution, you elect the board, you decide what happens
  - The market knows this
  - So if someone wanted to buy a company, and we didn't have all these other rules, they would only buy the 67% chunk – because what's the point of buying the rest?
    - The value of a corporation is only while it is a LIVING corporation, so the fact that you can participate on liquidation is useless

  - So this is why we have the takeover bid rule – in order to keep a well-functioning marketplace, in order to avoid the unfairness of the minority shareholders being trapped
  - The takeover bid rule says – if you buy more than 20% of a company, we're going to call that "control" – 20% is essentially where control starts

  - The amount extra you pay to get control is called the control premium – thats the amount over the trade price of an individual share that you would pay for a share that's part of a control block
  - This rule makes sure that the control premium is shared with the little guys

- **This case is entirely about the Billeses trying to not share the control premium with the little guys**

- So what happened:
  - 17.4% of the common shares were held by the Dealers – the people who actually own the CT stores
  - The Dealers in this case was a non-share company that was jointly owned by a bunch of CT owner-operators and was being used as a vehicle by which to acquire this company

  - Some smart banker read the coattails agreement
    - When do the coattails kick in? – the coattails said that the coattails were only triggered when 50% or more of the company was offered for (they were written at a time when there was trust in mind) – loophole
    - The dealers already owned 17.4% so they could make an offer for 49% to the Billeses – that would give them 66.4% of the company
    - The Billeses were offered 400% of the market price of their securities by the dealers

- So the Billeses and the dealers enter into an agreement
  - The agreement was subject to a **negative ruling condition:**
    - Contracts don't happen all at once – usually, you sign the agreement on some day and you close the agreement on some other day because there is a whole bunch of stuff that has to happen first
    - So you sign the agreement and you say, as long as certain conditions are met, I'll close the agreement on this day – the closing conditions
    - A common closing condition: there cannot be a ruling against this transaction by any court/regulator/etc

  - The agreement was a typical friendly takeover
    - It says, you make a takeover bid, and I agree to tender my securities to your bid

- **The all holders/best price rule doesn't protect the class A shareholders here because the all holders/best price rule applies *internally* to a class of securities**
- If you're making an offer for 20% or more of a *class* of voting securities, you have to make that offer to the rest of the *class*
- So the dealers made the offer to the class of common shareholders, they did not make the offer to the class A shareholders
  - They made an offer saying we will pay this price to whoever wants to tender to it, and we're only taking 49%
  - Anybody who wants to tender to it, can – and we'll just buy pro-rata from anyone who tenders
  - So if nobody else tendered, they would buy all 49% from the Billeses, if somebody else tendered, they would buy a little less from the Billeses and some from the others to get a total of 49%

- The OSC did not like this
- The OSC staff brought a motion before the Commission for a cease trade order on the basis that the public interest test was not being met
- **The Commissions in BC, ON, etc, they each have the power to make orders in the public interest**
- In this case, s. 123 (now 127?) is the section we're talking about (**<u>equivalent in BC: s. 163</u>**)
  - Because here, there was no violation of the Act or regulations
  - **But the Commission staff believed that letting the transaction proceed would be clearly abusive of the investors and marketplace, whether or not the transaction was in breach of the actual rules**
  - Why did they think that the coattails were contrary to public policy?
    - **They said (reasoning): allowing a coattail to be circumvented while still allowing the control premium to be captured by the seller is abusive of the market and would erode public confidence in Canada's capital markets – if you allow the control premium to be captured in these circumstances by sellers where there was coattails put in place to try to ensure that the control premium was shared with the minority interest, then it would erode public confidence in Canada's public markets – thus cause long-term harm to the entire marketplace**
    - Respondent's argued: there has to be an actual breach of the Act or regulations in order for the ON Sec Com to Act
      - Argued it was contrary to the long-term public interest for the OSC TO intervene – rationale: it defeated <u>reasonable reliance</u> – there has to be certainty! We want to have certainty in these kinds of provisions
      - Participants in the marketplace should be able to reasonably rely on the language in the instrument they're buying and selling – the language in the instrument here says as long as you don't offer for over 50% or more of the company, then the coattails don't get triggered

- **The Court agreed that the public interest jurisdiction is a broad and unfettered power that allowed the OSC to make orders to stop a trade which it deems to be contrary to public interest**
- **Shows the broad deference that the courts give to the commission**
- **A THEME: BROAD DEFERENCE TO SC**

- What is the trade that dealers want here?
  - What is the transaction in securities in this case – transfer of common shares
  - So the cease trade order applies and says we are not going to let the common shares be transferred pursuant to this offer because the offer is an act in furtherance of a trade

- **<u>SO</u>:** a cease trade order is not limited to situations where there is a violation of the Act/Regulations – it can also be used to "public interest" jurisdiction
  - Court said, they could use the cease trade order – even if we didn't let them do it that way, they have the power to pass a regulation to stop you so at least this way, we are letting them do it in the most efficient way possible

- **The Court said: The Commission should act to restrain a transaction that is <u>clearly abusive</u> of investors, whether or not it directly contravenes the Act**
  - This seems to be abusive of the reasonable reliance argument
  - Argument was: capital markets can't operate in an environment where you don't know if a provision in a document will be honored or not

- Argument: unfairness is a fundamental characteristic of the capital markets – you end up in unfair situations all the time
  - **Court acknowledged this and said Commission should only act if clear evidence of abuse is demonstrated**
    - **Abuse does NOT equal unfairness**
    - **Abuse has to have a systemic quality**
    - **There has to be a broad impact on capital markets in general for an action to be abusive in the sense that it supports an action by the Commission to take the cease trade order pursuant to the public interest jurisdiction – it's a broad jurisdiction but there has to be abuse there to support the use of the jurisdiction**
    - **<u>RATIO: Abuse</u>**

- If you brought an action to try to say that a cease trade order founded on a public interest jurisdiction was improper because it was not founded on an action that was "clearly abusive of the marketplace" – this is a loser of a case – think of something else

- <u>Here</u>, there were some facts that supported the Commission's decision:
  - 8% of the equity controlled the company and 92% was silent – given that disparity, the courts found the coattails had to have a disproportionate effect on the willingness of people to participate in the class A common shares
  - Remember why the Billeses came up with the class A shares to begin with – so they wouldn't lose control of the company
  - So Court found that the transaction was designed to skirt the coattails provisions and was therefore abusive of the marketplace
  - But: where is the line?
    - They went for 49% but what if they went for 33%? – that would have given them 50.4% so there is effectively no difference

- **<u>Important things to take away:</u>**
  - **Commissions have the power to make cease trade orders on the basis of their public policy jurisdiction – those orders can be directed at actions that are abusive of the marketplace even if no breach of the Act or regulations is present**
  - **The courts give immense deference to the decisions of the commission – SO: unless you have an error of fact or the law, redesign your approach to the problem**
    - **Unless the commission has made a plain and vital mistake, it's decisions will stand**
    - **Unless you can point to an <u>error in principle</u> or a <u>misapprehension of facts</u> – but if there is any kind of judgment call, the courts just are not going to question the commission**

In the Matter of Selkirk Communications Ltd et al 1988 ON

- Another OSC case
- Here, Selkirk had 2 classes of shares:
  - Class A?
  - Class B?
  - Southam owns 40% of As and 20% of Bs

- **Oct 15** – Rogers announces that it is going to make a takeover bid, but the takeover bid is conditional on 100% of Class A shares being tendered to the offer
    - Takeover bids can have conditions on them
    - This is an example of a **minimum tender condition** – how many shares have to be tendered to your offer before you're actually going to go ahead and take the securities – typically, it's 66⅔%
  - So if a single class A shareholder turns them down, they are not interested

  - Before the announcement was made, share price was **$25/share**
  - Immediately after announcement, it went up to **$33/share**
  - Rogers's bid was only in the marketplace for 6 trading days

- **Oct 20-**something (6 trading days later) – Rogers pulls its offer
  - When it pulls its offer, the share price drops to **$21/share**

- What happened? Why was this interesting?

- **Nov 3** – Southam agrees to buy from Cable Cast 630,000 shares at **$26.50/share**
  - And it gives them upside protection
  - **Upside protection:** If I, in a certain amount of time, sell your shares to somebody else, I'll give you the upside or I'll split it with you or something

- **Nov 6** – same deal: they get another 375,000 shares on the same terms
  - Note: these are upstairs market trades – individual negotiated transactions
  - When they went up and bought these, they made the trade subject to there being a good exemption from the takeover bid rules for the acquisition of the securities
  - Because: Southam, owning 40% of the As and 20% of the Bs, if it buys a single share more of either of those classes, it will have bought more than 20% of the company, so buying 1 more share of either of those classes is a takeover bid – **the first share you buy that takes you over 20% is a takeover bid and you have to give all holders the best price, unless there is an exemption**
    - **There are 2 exemptions that typically get used for takeover bids:**
      1. **De minimus trades?**
      2. **Private agreement exemption:** as long as you buy from NO MORE than 5 shareholders for no more than 115% of the market price, its not a takeover bid
          - The typical takeover bid premium is 35%
          - 115% is clearly far below that – and that is the essence of the private agreement exemption
          - The private agreement exemption is quite clever: what it is saying is, nobody sells control or anything really mildly valuable for 115%
          - So if what you're selling is only getting 115% of the market price and it is a true arm's length trade, and you are actually valuing in all the considerations (side-deals – called collateral benefits – get rolled into the evaluation), these 5 investors aren't selling anything that is really valuable so this should be okay in the marketplace
          - It allows a little bit of relief from an otherwise draconian rule, which is that anything over 20% is a takeover bid

  - So these trades on Nov 3 and Nov 6 were subject to being in compliance with the laws
- **Dec 9 and Dec 11** – they went back and modified the deals such that in no event could they get more than 115% of the market price of the securities (even with the upside protection) – this was specifically to make sure that there was no way to criticize this trade for being in something that was offside the private agreement exemption

- BUT here is the problem:
  - These were at $26.50

- The trading price was $21
- The $26.50 was higher than 115% of $21 (which would be $24.15)
- So on the day, it was higher than 115%
- But that's not how the rule works – **the rule works on a 20-day volume-weighted average price**
  - You look at the trades over the past 20 days, looking at the volume-weighted prices
  - If you have a small number of shares being sold at a significantly different price, it doesn't change the average price much, because it is volume-weighted
  - You look at *how much was sold at each price, not just at the price it was sold at*

- SO: if you look at the volume-weighted price over this entire period, you include the lump when Rogers was making their offer, which Southam turned down
  - So Southam turned down that deal, but then they said, we are going to take advantage of the fact that they were in the market with that offer to offer more than they would otherwise offer even though we were the ones that said this wasn't going to go forward
  - This bugged people – because the reason why *everybody* wasn't getting $33 was because Southam said no, but they only reason Cable Cast could get $26.50 was because Rogers was in the marketplace in the first place

- Similar to the Canadian Tire case – the rules allow what Southam did
  - Southam did the volume-weighted price over the 20 days, offered within 115% of that price
  - But the staff didn't like it – they argued that those days when Rogers's bid was in the marketplace should be excluded on a public interest basis because the exemption is predicated on only a small premium being paid, that's the whole idea behind the exemption, only 115% over the market price can be paid, as a result, you're not going to be able to get significant market positions
  - What Southam was doing was taking advantage of the abnormal trading volumes that came about as a result of Rogers's bid
  - They were basically circumventing the rule by artificially inflating the volume-weighted average price

  - Southam argued the certainty argument – the rules allowed this
  - The 115% rule was complied with and as a result with respect to
  - Invoked public interest jurisdiction – said because the only reason this pop existed for Southam to go out and purchase the

  - ***Also note***: the Act had recently been amended at this time to remove a certain amount of discretionary power that the Commissions used to have – in exchange, they lengthened the volume-weighted average price from 10 days to 20 days

- **Decision:** OSC decided the 6 days should *not* be excluded – the Commission staff was wrong to think that they could reach in to an averaging period and take out days that were abnormal
  - The 115% rule was complied with – as a result, with respect to that aspect, Southam was not offside
  - NONETHELESS, they didn't allow Southam to move forward because they invoked the public interest jurisdiction and said that because the only reason that this opportunity existed for Southam to purchase Cable Casting's shares at $26.50, was because of Southam's own refusal of Rogers's bid – this was prejudicial and abusive of the marketplace
  - One commissioner said: it is more offensive when a purchaser relies on an exemption in a context where they themselves blocked a premium offer to all shareholders – this is what happened here
    - Rogers was willing to pay $33 to everybody
    - Not only did Southam tank that deal, but it used that opportunity to get more control at a low price for itself

  - Note: there was a dissent

- Note: these decisions are OSC decisions, but the rules are identical between BC and ON, so the principle

- OSC decisions are not strictly binding on BSC but they are found to be incredibly informative – ON it is the largest and busiest in Canada, and is seen to be the one with the deepest well of expertise
- **Theme: deference to expertise**
- Since Ontario is seen as being the deepest well of expertise, they would get the most deference

Self Regulatory Organizations

- There are a few SRO's
- The big ones: IROC and TMX

1. **<u>IIROC</u>: Investment Industry Regulatory Organization of Canada**
   - Anything before 2008, you'll see IBA and Market Relation Services
   - In 2008, they merged to form IIROC
   - So IIROC is now the successor to the IBA and MRS

- IROC is kind of like the law society of BC
- It is made up of its members
- It has members of the investment industry who get together and vote on stuff
- It is an SRO in the sense that members of the investment industry get together and set standards by which the investment industry operates on a very granule level

- There are two main bodies of rules that IIROC has:
  - The dealer member rules ?
  - UMIR: Uniform Market Integrity Rules

  - Deals more with dealers
  - *Ex. front-running* – you see all the investment orders coming in from the brokers, and you can front-run by trading ahead of those orders and capturing the little bit of spread that happens because the current market price doesn't have this huge volume of order information priced into it

2. **Another SRO: TMX is basically the Toronto Stock Exchange (recently merged with Montreal)**
   - TSX has 2 main separate exchanges: TSX and the TSX-V
   - The TSX is the senior exchange – the rules you need to meet in order to get onto the exchange are higher
   - TSX-V is the junior exchange – venture exchange – where smaller junior securities go to exchange their securities, so it has a lower threshold for listing

   - They both have listed company manuals which contain rules that those who are listed on the exchange have to abide by or they run the risk of losing their listing

SELF-REGULATORY ORGANIZATIONS

***In the Matter of Torstar Corporation and Southam Inc* [1968] OSCB 3088**

- When you want to engage in any transaction that involves the issuing of securities, and you're listed on an exchange, obviously you want those securities to trade on the exchange, otherwise you're not going to get full price for them and it'll make your life difficult to have some securities trading and some not
- The exchange, before it will allow you to list new securities on its exchange, requires you to come get their permission
  - They have all sorts of rules for what kinds of transactions require what level of permission – basically, they want to be involved in each transaction where you are issuing securities when you're listed on the exchange

- In this case, Torstar and Southam conducted a share exchange but they didn't wait the requisite notice period required by the TSX
- Their reason was that there was a rumored takeover bid and they were unwilling to wait the period it would take for TSX notice period to expire

- The purpose of this deal seemed to be to lock the control of Southam with Torstar and Torstar with Southam, thus making the takeover more difficult by essentially having significant block of shares in friendly hands
  - **This is called entrenchment – this is bad**
    - **Entrenchment is actions that are taken by the existing management of a corporation that are designed to preserve management's control of the corporation at the expense of the shareholders**
    - Remember: directors are supposed to act in the best interest of the *corporation* – not management, shareholders, etc. (***BCE decision***)
    - **So: taking actions that prefer one set of stakeholders over another set of stakeholders without any consequent benefit to the company is clearly entrenchment**
    - It's just making management more secure

  - The TSX is all about ensuring that people who trade on its exchange trade in companies that are going to be acting in a way that's not detrimental to the shareholders
  - And if there are actions that prefer managements' interests over the shareholders' interests, then the TSX is going to be upset

  - Here, not only were they engaged in entrenchment, but they didn't wait for the TSX to make a decision – they just went off and did it
  - But the TSX didn't want to just kick them off the exchange – **delisting wasn't sufficient for situations like this, because how are you going to go about rectifying damage to shareholders by taking away shareholders' liquidity? – that doesn't help, you're just hurting the shareholders**

  - So the TSX applied to OSC for a sanction against the rule-breakers
  - In the end, the decision of the OSC was to leave the transaction alone but all the directors in both the organizations were prohibited from acting in the markets for 6 months
    - When you're prohibited from acting in the market, you're effectively prohibited from acting as a director or officer of a public company
    - Essentially they all lost all their jobs

  - **This was the beginning of the wave of TSX now accessing the commissions to help them police rogue companies**
  - It's interesting that the TSX had to go and get the OSC to come help

DISCLOSURE REQUIREMENTS AND LIABILITY

BCSA s. 132(1): 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.

BCSA s. 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.

BCSA s. 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,

BCSA s. 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

BCSA s. 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))

BCSA s. 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.

BCSA 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.

In the Matter of Royal Trustco Ltd, K White and JM Scholes 1981 ON

- **Issues: tipping case and a material fact case**
- **Tipping:**
  - Tipping is a violation of insider trading laws
  - Insider trading rules have 2 parts:
    - 1. Insider trading – when you hear some sort of confidential information about the company that isn't known to the public and you go out and buy yourself securities on the basis of that information and you make a lot of money
    - 2. Tipping – you work for the company and you tell confidential information to somebody else – if that person goes off and trades on it, you're just as liable as they are

  - *When a share price runs – when 2 companies in discussions and one of their share prices suddenly starts to go up without any news in the market, what's going on? – its because somebody has been whispering about the impending deal – this wipes out deals*

- **Facts:**
  - Aug 26: Campeau Corporation tells BMO of their intent to make a bid for all of the voting securities of Royal Trustco
  - Aug 27: the CEO of Trustco, White, is informed ?
    - His reaction is aggressively negative – he is pissed off, he thinks its undervalued, etc.
    - But he goes and really aggressively campaigns against the Campeau bid
    - He canvassed shareholders, telling them Campeau is opportunistic, etc.
    - Went out to look for a white knight – all the defensive tactics
  - Oct 2: the bid is withdrawn by Campeau

  - What White did successfully was establish a wall of friends and supporters who pledged that they would not tender to Campeau's offer
  - After Campeau pulled the bid, they brought charges
  - Counter charges were brought – it was a mess
  - Sanctions were sought by OSC staff against Trustco on the information brought to them by Campeau

- They alleged that Campeau failed to disclose fully the actions taken by Trustco to oppose the bid and the fact they knew there were parties in the marketplace who acquired shares specifically with the intent of not tendering them to the bid
- Secondly, they said Trustco had tipped TD Bank by going to TD and saying: 60% of the shares are in savings? (will not be tendered), so you shouldn't tender them – and that was not information that was put into the circular
  - They also told TD that they might be increasing dividends – again, not something that was in the circular?
- So: both failure to disclose and tipping

- They focused on the disclosure around the shareholders that said they weren't going to tender, etc.

- There was a dissent: the dissent was: what would a prudent person do?
  - Would they publish in the disclosure: we've talked to the shareholders, this many have expressed intention to tender, this many have expressed no intention to tender – No!
  - You can't publish numbers on how many shareholders are going to tender, how many aren't because when you're publishing those kinds of vague numbers, then what you're going to have is the OSC coming after you for publishing those vague numbers because it is speculative – you don't have a basis for reliance on this information
  - In fact, you have NO basis for relying on this information because half of them are lying to you

- This case goes to show the OSC will come after you failure to disclose information

- **Whats the definition for materiality? – whether or not it will affect the price of the security**
  - **So if you think this information will sway shareholders' decision on whether or not to sell at this price, then it is by definition, material**

***Sparling v Royal Trustco Ltd* 1984 ONCA**

- One of the things that the CBCA has built into it that we don't have in the BCBCA is liability for misrepresentation in circulars
- In BCBCA, it's all lumped under securities laws
- The CBCA actually has it in the Act
- CBCA s. 198(3)
- Even though this section has been repealed, the case is still important
- The case is about material omissions

- Here the director of the CBCA brought an action for damages against Trustco and its directors for failing to make material disclosure

- **The juicy bit: they found that an omitted fact is material in the context of a takeover bid if there is a substantial likelihood that a reasonable shareholder would consider the fact important in deciding how to vote (i.e. whether or not to tender?)**

***Fait v Leasco Data Processing Equipment Co* 1971 US (*Surplus Surplus Case*)**

- Note: this is an American case but is tangentially applicable to Canada
- Important bit on p. 574:
- Here we have a takeover bid in circumstances where smart financial planning __ figured out that there is this insurance company that had a surplus surplus
- What is a surplus surplus?
  - Surplus is a term that is used in regulation of insurance companies – you have to have a certain amount of capital to fund claims on your insurance policies
  - And you have to have a certain surplus over the amount of expected claims as a cushion against unexpected claims/litigants

  - There is regulation about how much surplus you're required to have – so you have to have your expected claims + certain percentage that you're required to have by regulation to account for these unexpected claims

- What this person did was, they were digging around int he financial disclosure of this company and they determined that they had too much surplus – they had surplus surplus – and nobody knows it!
- It was clear in the disclosure record that no one had ever figured this out before
- There were millions of dollars in this company that you could just take off the company, give it out to the shareholders, whatever – you could take that away and they would be within regulations
- And nobody was giving value to this in the marketplace because everyone thought this was money that they were required to have on their books and therefore it wasn't available to give to the shareholders

- **So they went out and made a bid for the insurance company – the question was: you know this secret, do you have to tell the people you're buying from?**
  - **The answer is yes**
  - **Even if the information that you, as the offeror, know is information that only you know (the company doesn't know and no one else knows), you still have to put it into your circular and failure to do so is material omission**
  - Its counterintuitive because you think: well the information was all available information, it wasn't insider information – this doesn't matter
  - A material part of the evaluation of the company was that excess surplus on the balance sheet – this was available as dividends to shareholders
  - As a result, when they didn't say anything,

DEFENSIVE TACTICS AND DIRECTORS' DUTIES

Teck Corp v Millar **1973 BCSC**

- The leading Canadian corporate law decision on a corporate director's fiduciary duty to resist a takeover bids.
- Teck had been interested in a mining property in Kamloops
- Company named Afton Mines ?
- Teck went to Afton – tried to acquire them
- Afton Board wasn't interested
- Board felt that they were probably too small to develop the property on their own so they looked around for somebody else who they thought would be a good fit for them – came up with Canex
- Canex felt that together they would be able to build a good company
- So the Board of Afton issued shares from treasury to Canex

- Unfortunately, the issuance of shares were 1 day after Teck, through the public markets, had acquired a majority of the outstanding shares of Afton
- What was surprising: the price Canex was paying for the shares was less than the price that Teck was paying for the shares that were publicly traded – and it was less than the price that Teck had offered to pay to acquire all of the shares of Afton

- **The case was decided by BCSC**
  - **He concluded that it was not sound to limit the directors' exercise of their powers to the extent required by Cramphorn (UK case)**
  - **The directors are entitled to resists a takeover bid if they meet a two part test:**
    - **1. They must act in good faith in resisting the bid**
    - **2. They must believe on reasonable grounds that the takeover bid will cause substantial damage to their company's interests**

    - On the facts: the directors of Afton had satisfied their fiduciary obligations

        - He placed the burden of proof on Teck to show EITHER that the directors' purpose for rejecting the bid was not in the best interest of the company or that the directors did not have reasonable grounds for believing that the takeover bid would have caused the company substantial damage

    - **In assessing the best interest of the corporation, Teck provided that the directors may consider a variety of different interests:**
        - **1. Who is seeking control and why? It is material to assess the reputation of the offeror, previous experiences that people have had with the offeror, policies of the offeror (find this in the text)**
        - **2. You're entitled to consider the interests of employees and consequences to the community in general**
        - **3. The impact on the corporation and the shareholders**

        - **So Teck was a clear departure from the old strict proper purpose test of Cramphorn**

    - **Court concluded that the court should only find the directors' exercise of their power to be improper if their purpose was not to serve the best interests of the corporation**

    - So the court was basically was looking at the Paramount fact pattern:
        - Where Paramount had been around for a while wanting to acquire but there had been a discussion between Afton and Canex to get together and create value
        - ***Despite precedents, the court decided, you are able to look at who the bidder is – we know Teck, as soon as they acquire, they'll just tuck it away as another asset, they may develop it, they may not***
            - ***They offered a price that is better than the current price but its probably still less than its worth***
            - ***They can look at their employees – they will probably all get fired***
            - ***Can look at your long-term values***
                - ***If you decide this will have a bad impact, will destroy value – you are entitled to just say no to the deal***

- There aren't that many cases that have looked at this decision, but there are a few – first one:

Re Olympia & York Enterprises v Hiram Walker Resources **1986 ONHC**

- There is more to H Walker than just the booze business
- H Walker is best known for whiskey

- They also had an interest in a pipeline, Interprovincial Pipelines
- They were also in the consumer and gas business – gas going to homes in Ontario, primarily

- H Walker held 34% of Interprovincial Pipelines
- And IP held 15% of shares in HW
    - Interlocking shareholding
    - Company was well-managed
    - BoD has 14 directors – 8 were independent, 6 were management nominees – they set up a special committee

- Olympia & York is the competing bidder – they own Golf Canada
    - O&Y was owned by a family
    - O&Y causes Golf Canada, their subsidiary, to make a bid

    - O&Y holds 14% of the shares outstanding of HW

- HW had both voting and non-voting shares – they had 10% of the votes, 14% of the common shares outstanding

- They wanted to acquire 37.1% of the shares of HW (that together with 14% = 51% of company)
- They make a hostile bid (friendly failed)
- They don't offer much money – 26 million shares at $32/share

- BoD of target company advised by management – there isn't a lot of value here
  - They think what OY wants is to take control of the company and then take the distillery business and sell it off because they aren't int he distillery business
  - So they want to sell the distillery business, take the cash and then take the company private
  - They're low-ball bidding with the price and the percentage they want to acquire

  - So Board tries to find another bidder – found UK called Allied Mines PLC that had written letters in the past saying they were interested in acquiring the business
  - Allied Mines agrees to buy for over $2 billion

  - Board of HW (the subject of the hostile bid) bought 50 million of their own shares??? – paid $40/share
    - They haven't involved anyone outside taking control of the company
    - Instead, they have identified that there is an asset in the company that has substantial worth – and with a restructuring, I can now take the shares, take the cash that I get on the sale of the business, and cause the shares to be repurchased by the company at a price substantially greater than the offer and a higher percentage of the shares – I'M SO CONFUSED
    - Under the tax laws in place at the time, if HW had bought back their own shares, it would have resulted in a dividend tax treatment – which was at the time very unfriendly compared with capital gain
    - So they worked together with Allied Mines to create a special company called Fingas
    - Fingas was capitalized from the value that was being paid from the business
    - Fingas was the one that actually made the offer – steps out into the market and buys 50 million shares at $40/share
    - Fingas is 49% owned by an individual, 2% by some other individual, and

- So they tried to go to court to have this set aside arguing that the Board is entrenching themselves because this Fingas company together with the interlocking shareholder could effectively control the company in the hands of its Board – WTF???

- This is just a setup they have created to entrench themselves

- ONSC says Nope – court is satisfied that the desire to create Fingas, while it is technically not lawful in Ontario to capitalize a company with a contribution from your own company, court is satisfied that they had obtained advice in the short period of time they had (back then it was 21 days for a bid, not 35), they had come up with a competing transaction but a competing transaction that was at a substantial premium compared to what was being put on the table by Golf Canada
- Court said it will not set aside the business judgment of the directors in determining that this is a better transaction for the shareholders than letting Golf get away with this partial bid

- The case holds that HW's directors acted in the best interest of the corporation and in good faith and that as a consequence, it was irrelevant that they also benefited from their actions by becoming more entrenched in the company

- Quote:
  - Applying the Teck formulation, Montgomery J. held that the directors of Hiram Walker had acted in the best interests of the corporation and in good faith and, that as a consequence, it was irrelevant that they had also benefitted from their actions [by becoming more entrenched in the company].

- While reinforcing the existing rules of the Teck test for directors' use of anti-takeover defenses, Re Olympia & York also supplements it with the following additional principles(105) :
  - 1) it is the duty of directors in a take-over contest to maximize the value to all shareholders;
  - 2) directors are entitled to rely on professional advice as to the adequacy of a bid, and such reliance will constitute evidence of acting in good faith and upon reasonable grounds; and
  - 3) self-entrenchment will not necessarily be inferred where retaining control is secondary to the primary purpose of acting in the best interests of the corporation and in good faith.

- Between Teck and Olympia & York, you basically have the establishment of a new modern framework in which directors' actions in Canada are to be considered

***Pente Investment Management v Schneider Corporation* 1998 ON**

- Maple leaf foods really wanted to acquire Schneider
- Maple Leaf was worried that its cost structure was pretty high – they felt that Schneider was not charging high enough for some of its premium products and Maple Leaf would be able to do a lot better with the company
- Schneider, despite being 180 years old, was still owned by the Schneider family
- Maple Leaf came along and offered $19/share? for all of the voting and non-voting shares of Schneider
- The family felt that the value was being proposed was inadequate
  - They felt that Maple Leaf made no attempt to be friendly with the Schneider management or family
- The $19 offer wasn't a bad offer – shares were trading at $14
  - Not a huge premium, but a premium
- The Board, faced with the offer, set up a special committee comprised solely of independent non-family directors?
  - They decided to hire outside financial advisors, etc.
- Schneider family said clearly, we don't like the bid – without saying much else

- The financial advisors did a canvass of the market to try to find other potential bidders

- Maple Leaf refused to sign a standstill agreement (??)
- There is a canvass that is being undertaken by the board
- If you're interested in doing something, go get us a better offer

- Maple Leaf raised the price to $22?

- Another group said they were interested at $24.50
- Smithfield offered $25/share
  - They were interested in listening to what the family wanted
  - Smithfield gave the family the ability to exchange their shares for shares in the new company they would create (to avoid tax liability) that will be worth $25 but you can defer your tax payment

- So the Schneider family said they would consider our shares to Smithfield because they meet our requirements, which are:
  - **We want someone who will keep the management/employees/the plant/the name of the company in Canada and would give us a continuing role as a member of the board of directors and who would give us a structure that would allow us to defer any capital gain that we might realize (to avoid tax consequences)**

- **The financial advisor looked at the Smithfield offer** which was basically for shares in Smithfield and said you know, fair value of the shares might not be $25, but its probably more like $22-$23 whereas the other offer (something Creek) of $24.50 cash (was urged to go up to $25) – so if your

view was to get a cash offer, the other offer was a better option but the family said NO, we're not prepared to sell to just anybody

- Because you've signed a confidentiality agreement with a standstill provision (???), we need you to waive the standstill to allow them to buy our shares (because with a standstill in place, they can't buy)

- **Case came down to: how did the directors exercise their fiduciary duty allowing the bidder who is not the highest bidder to go forward with their proposal when it isn't the best value for the company?**
  - A change of control for the company is inevitable, but in a circumstance where change in control will occur, why doesn't the board have the duty to get the best price?

  - **Maple Leaf apparently raised their bid up to $29 CASH (compared to $25 in Smithfield stock, which was actually worth $22-$23)**

  - So how would court decide? – allow directors to waive the standstill to let the Smithfield bid go forward?

  - They were responding to an argument that Maple Leaf made based on a US case called **Revlon**:
    - **The Revlon standard:** when a change of control of a company is inevitable, the role of the board of directors shifts from the long term view to maximizing the short term value
    - Effectively, under Revlon, the directors would become auctioneers charged with getting the best price they can

- Argument Maple Leaf was making in this case: this company was going into Revlon mode, we know a change of control is inevitable, Smithfield, if they're successful, will change the management of the company so the directors have a duty to get the best price possible

- Ontario Divisional Court:
  - Problem here is that Revlon doesn't apply because a change in control in these circumstances isn't going to go to the highest bidder, it's going to go to whomever the family agrees to sell to
  - The family has voting shares and the family isn't obliged to act in the best interest of all the shareholders
  - The law in Canada is that the family can vote in their own selfish interest
  - *Remember: the family has the controlling block of shares*
  - Shareholders in Canada don't owe duties to other shareholders – they can act in their OWN best interest
  - So when the family decides that they are prepared to sell to the Smithfield group because they are getting all these other objectives met, that's the only transaction there is – there IS no other battle for competing control
  - In this circumstances, the directors have to look at what is available and clearly, a high offer pure cash transaction is not available
  - This is NOT AN auction
  - So the directors, in an attempt to have the transaction go forward are asking appropriately to waive the standstill

- It is a question of what falls within a reasonable range of alternatives and there was NO alternative that maple leaf could ever put forth that the shareholders were prepared to tender to

- **The case is often cited now as holding that Revlon is not the law in Canada**
  - **Prof thinks what the case stands for is that in circumstances of *this case*, Revlon is not applicable, it would be an overstatement of the ratio in this case to say Revlon is not the law in Canada**

***CW Shareholdings Inc v WIC Western International Communications Ltd* 1998 ON**

- CWS made a takeover bid for the CTV affiliate, WIC, controlled by a family
- They had accumulated a significant toe-hold stake in the company
- CW owned 35.7% of the shares at the time the takeover bid was launched
- They made an offer on March 24, 1998 at a price of $39/share
- The shares were trading in the $20s
- They bid for 2 classes of shares:
  - Voting class of shares (Griffiths family had held and sold to 2 families: Shaw (50%) and Allard (50%))
  - Non-voting shares – Shaw: 14% , CW: 35.7%
- March 24: CW bids to buy the rest of the As and Bs at $39/share
- April 3: Board of WIC establishes a second committee – they make a mistake, they put the CEO on the special committee (he was not independent)
  - **You should not put the CEO on the special committee**
- They adopted a shareholder rights plan
- April 9: AB and ON SC striked down the shareholders right plan immediately, saying they can't adopt a pill in the face of an offer
  - The law has evolved since then – this would not apply anymore

- April 10-15: Shaw family was asked to submit a bid (by the special committee represented by the CEO)
- April 17: Shaw family, faced with the immediate expirty of the CW offer does step up – offer $43.50/share for all remaining shares
  - $35 in cash and some Shawn B stock

- They struck an agreement with the management of WIC and approved by the Board – pre-merger agreement
  - Under that agreement, they agreed to pay a **break fee of $30 million** and they were given an asset option? to acquire the radio stations that WIC held for a price of $160 million
  - It was felt that those inducements were necessary to bring Shaw forward

- April 30: CW agrees to increase its offer to $43.50/share
  - CW is beyond mad
  - Goes to court and tries to say that the Board at WIC was not acting in the best interest of the company but were acting in self entrenchment
    - Could see this in the $30 million break fee and the asset option which was worth a lot to a company which elected half of the Board (Shaw owned half of the voting rights)
    - So they wanted the court to set aside the pre-merger agreement, set aside the asset option, and the break fee
    - They said there is no reason to support this when the price they were bidding was the same price that CW was bidding
  - **Question was:** how would the Board decide in a circumstance like this where it clearly looks like they are trying to entrench themselves (since half of these people were elected to the Board by the controlling shareholder

  - **Court:** decides against CW
    - Notwithstanding the taint to your process of having included the CEO on your special committee, we are satisfied that the special committee was advised by independent legal and financial advisors and that there were difficult circumstances faced here with the first bidder having 35.7% which is enough to stop any special resolution and then to have a bid at $39, to induce a second bid, it was an appropriate action on the part of the Board to grant both the break fee and the asset option
    - The decision takes you through the rationale for being able to give a break fee
    - Also goes through the rationale for being able to approve an asset option

    - Talks about general duties of a directors of a corporation – fiduciary duties
      - How the Revlon case was decided

- The duty of the board in that case does change to the maximization of the company's value as – may significantly alter the board's responsibilities
- **In the circumstances, it is appropriate for the Board to have acted the way they did**
- **The business judgment rule applies – the business judgment the board exercised is not going to be set aside**
- **The onus does not shift on the board of directors of WIC to justify their actions**
- **Re the break fee:** I accept that break fees are appropriate in circumstances where, as the commission has noted, they are necessary in order to (1) induce a competing bid to come forward (2) where the bid represents a better value for the shareholders (3) where the break fee represents a reasonable commercial balance for the potential negative effect as an auction inhibitor and a potential positive effect as an auction stimulator
- In that case, the quantum of the break fee was 3% of the transaction value – there is a later case in Canada called PACIFIC Papers?? – where the break fee was 4 or 4.5% and the court ruled as long as it is not greater than 5% (between 2-5) – the norm in Canada is 2% of the transaction value
- **Re the asset auction –** sometimes called an asset lockup – In my view the granting of an asset purchase option (or "asset lock-up", as it is sometimes called, in the jargon of the trade) to a potential bidder may be a proper and acceptable measure for a target corporation to adopt as a competitive-bid-stimulating inducement where - viewed in the context of the entire negotiated transaction, as in the case of break fees - it strikes a reasonable commercial balance between its potential negative effect as an auction inhibitor depressing shareholder value and its potential positive effect as an auction stimulator enhancing shareholder value.

- **Factors to be considered in distinguishing between an asset lock-up which is an auction stimulator and one which is an auction inhibitor.**
  - (a) whether the process by which the directors of the target company exercised their obligation to maximize shareholder value complied with their duties as target-corporation directors;
  - (b) whether the overall commercial balance and proportion between the auction inhibiting and auction stimulating effect of such an agreement in the circumstances has been struck, i.e., whether the agreement is likely to preclude further bidding, in the sense of harming or significantly dampening the auction process, and thus deprive the shareholders of potential additional value;
  - (c) whether the price for the optioned asset is within the range of reasonable value attributed to that asset, or whether it represents such a discount that it would result in a disproportionate erosion in the value of the corporation making it uneconomical for others to bid; and
  - (d) whether the competing bid induced by the asset lock-up agreement provides enough additional value to the shareholders to justify the granting of the option.

- Based on the facts of the case, the fact that it was so late in the process, etc., the court ruled in favour of the Board of WIC and upheld the business judgment that they exercised and didn't shift the onus onto the WIC Board to substantiate that what they had done was an acceptable conclusion

In the Matter of Sears Canada and Hawkeye Capital Management 2005 or 2006 ON SC

- Sears Holdings: US company involved in the department store business – owns 54% interest in Sears Canada
- They felt there was significant value in Sears Canada
- Sears Canada was able to sell its credit card business for billions of dollars
- It dividended out to shareholders the cash generated from the credit card business
- Price of Sears Canada falls – shares now represent an interest in the Canadian department store business

- Sears Holdings decides it is inefficient for it to maintain a separate public company in Canada and decides to take the controlled subsidiary Canadian subsidiary private
- They offer a price of $16.86/share for Sears Canada
- The Board of Sears Canada is stacked with people that were put there by Sears Holdings
- Some of the directors were nominated over time and were independent of Sears Holdings
- They received the offer of $16.86 from the parent company – to fulfill their obligations under securities laws, they establish a special committee comprised of independent directors, obtain independent legal and financial advisors and review the offer
- 15 days go by and Sears Holdings is going crazy because no one is saying anything to them about the offer

- All of a sudden the independent committee says we recommend everybody reject the offer
  - Its well below the rate of value that our advisors are saying is fair
  - Sears holdings goes nuts
  - They strike a lockup agreement with an owner of 9.1% of the shares
  - But they fail to disclose that they had given an agreement to that shareholder that if they paid a higher price to somebody else within 3 months after the purchase, that they would make sure they top him up
  - So they're giving them a "collateral benefit" – and they did not disclose this collateral benefit

- They go to the securities commission (OSC) to try to get an order from the securities commission forcing the Board of Directors of Sears Canada to go on and get its valuation by a set date
  - Commission didn't take kindly to this – they felt they were being pressured party because the Board of Sears Canada was informed by Sears Holdings that it is an intention of Sears Holdings, whether or not they're successful with the bid, to immediately cut the dividends Sears Canada was paying
  - So what is the effect of cutting the dividend? To drive down the value of the stock

- They go back out to try to find shareholders who are prepared to tender into the offer – they find a bank owning 4.2% of the shares and they structure a deal with the bank that would give them favorable tax treatment if they tender their shares into a restructured offer

- Then they go to the US real estate investment trust ? and they agree to lock up 7% of the shares in the company for $18/share – requires Sears Holdings to raise the price to $18 and again they fail to tell anybody that they granted deal protection to that shareholder for 32 months
  - So for NATO or ATO or whatever – it is assured that anything happens within 32 months after the date of this lockup agreement, in the form of paying a higher price, that they will pay it toward NATO whether they are a shareholder then or not

- So minority shareholders were unhappy with what happened – the same minority shareholders that just took control of Canadian Pacific – they were saying to the OSC, this Sears Holdings activity has to get set aside because effectively, what they are doing:
  - They started at 54%
  - They have the friendly tendering shareholder NAT CAN – 9.1%
  - They have another 4.2% from a friendly bank
  - Then they have another 7% from NAtO
  - So what are they doing – that's 74.3%

  - How many shares are outstanding that they dont hold? – 46%
    - As a result of these lock-up agreements that they have entered into, they basically have very close to the majority of the minority
    - And if you don't deny them the ability to vote the shares that they've bought, you're basically handing control of the company to them even though the price they are offering is inadequate and they are acting in a manner that is contrary to the best interest of the shareholders

  - Very unusual application – and OSC is still pissed about the application for immediate valuation

- Rules in favour of the minority shareholders
- Says:
  - If you want to access our capital markets, you have certain obligations – the obligations include treating people fairly and offering the same thing to everybody
    - With NatCan, you offered deal protection, you didn't offer it to everybody – that's a collateral benefit, that's not permissible
    - With the bank, you restructured the bid in a manner that allowed the bank to get tax free treatment in a manner that you didn't offer to anybody else
    - NATo – deal protection wasn't being offered to everybody

    - I'm going to DENY you the ability to vote ANY of these shares in favour of the forced going private transaction – now what you're going to have to do is:
      - Of the 46%, I'm going to knock out that 20.2% so now you're going to have to get 25.8% and it turns out that the minority shareholders who complained represented about 10% so now the majority?? has a just say no defence
      - Minority can vote in their self-interest – there is no obligation in Canada as to how you vote your stock
      - So the minority basically frustrated the attempted going private transaction involving Sears Canada

- A very fact-specific decision
- Does talk about the duties of directors
- In the circumstances, every director who is an independent director knew that the moment that this application came up that they would be thrown out ???
- But they immediately got a special committee, etc.
- And they supported the minority application to the commission

BCE Inc v 1976 Debentureholders 2008 SCC

- Key ratio in this case: oppression remedy
  - The complainant is the debenture-holders
  - There was a plan of arrangement – which is a corporate transaction (not a takeover bid)

- This case: it is a deal struck between the Board of BCE and the bidder to acquire BCE through a plan of arrangement
- The reason this is important:
  - 1. The BoD is engaged as part of the transaction – they do have a role to play as part of the transaction, other than providing a recommendation
  - 2. In order to get a plan of arrangement approved, the court has to issue an opinion that the transaction is fair

- Bear in mind the difference between a takeover bid and a plan off arrangement

- The complaint against the merger was brought by people who had brought debentures (a type of debt) from BCE
- At the time these debentures were sold to these investors, they were valued highly – basically treated as investment grade and they were given an investment-grade opinion by a number of firms
- Holders bought and sold these debentures over the years on the basis that this is an investment-grade obligation of BCE, ranking in priority
- When the Board of BCE approved the plan of arrangement, they understood that only $8 billion of new equity was coming into the company and that the rest of the bid was financed with debt
- When you load up Bell Canada (the subsidiary of BCE) with debt, the value of the debentures falls massively – you end up putting the existing debentures, which were regarded as investment-grade, …
- The rating agencies withdrew their investment-grade ratings and the holders faced 2 propositions:

  - The value of the debt had fallen and they felt compelled to sell and even if they didn't feel compelled to sell because the value had dropped, most of the Canadian investment funds, people that managed pension money, etc., have rules in their pension fund that they can't hold non-investment-grade debt
  - So even if they wanted to hold it and ride through the storm, they couldn't because the constating documents that governed the funds forced them to dispose of them – at this point, at a significant loss

- So the debenture-holders go to court in Quebec and seek an opinion from the Quebec court that their interests were not considered and that, in the circumstances, it would be unfair for this transaction to proceed (because in Canada, a court has to approve a plan of arrangement)
- So you can't get the fairness opinion from the court

- They secondarily argued that the BoD, in approving these transaction, acted in an oppressive manner in relation to the interests of the debenture-holders
  - They were motivated by the desire to get the highest price you could for the shareholders and there was good evidence that there was a prolonged process with 3 bidders and the Board ended up accepting one of the bids
  - They basically argued that when the Board of Directors, in response to these series of offers, selected this particular bidder, whose bid included a maximum amount of debt, you failed to consider our interests as debenture-holders and therefore acted in a manner that was oppressive of our interests

- **<u>QCSC</u>**
  - **The Quebec court and says: I am satisfied that the BoD acted appropriately**
  - **The Board ran through a process, considered the interests of various stakeholders, but they ultimately decided this was the best deal and in fact, their duty at law was to try to get the best deal they could for the shareholders because a change of control of BCE had become inevitable**
  - **They were applying the Revlon standard – that when a change of control of the company has become inevitable, the obligation of the Board shifts from the protecting the corporation and the long-term view to the obligation to get the best price they could**

- **<u>The matter goes to the QCCA</u>**
  - The CA reverses the trial decision 5-0
  - Nope, there is no evidence that supports that this Board, in this transaction, considered the interests of the debenture-holders properly
  - It made reference to another SCC case, People's Department Store, and decided that the BCE Board had failed to fulfill its obligations
  - And that in any event, the transaction wasn't fair even if it wasn't oppressive of the interests of the debenture-holders

  - This was the first time that the court said the highest bid isn't the transaction the Board should go for – that somehow, there is now this obligation in the context of a change of control transaction, that you have to go out and consider the interests of other holders and that the proper approach for the Board was to go for a transaction that did not lower the investment-grade of the debentures

- **<u>SCC</u>**
  - **Rules 9-0 against the CA**
  - **But there are no reasons for the decision – so everyone is waiting for a decision on what are the Board of Directors' duties in the face of a change of control transaction?**
    - The SCC talks a lot about the oppression remedy and they focus on these debenture-holders
    - They say, if the debenture-holders had wanted to protect the investment-grade rating attached to the bonds they acquired, they could have done so – they could have gotten a commitment from the company similar to the one originally in the Revlon notes, that said that the company wouldn't issue private-ranking debt ?
    - There were trust deeds in support of the different classes of the debt-holders
    - But the debt-holders never negotiated for value-protection

    - So to do what the QCCA did was rewriting the terms of the debentures after the fact to provide them with rights they never sought to negotiate in their own

  - So SCC said the obligation of the court is not to put the debenture-holders in a better position than they bargained for themselves
  - If there had been something that was done that was abusive of their interests, we would have to look at that but we don't find that in this case

  - They also articulate what are the obligations of a board of directors in a plan of arrangement – the case is cited as authority that the Revlon rule does not apply
    - It doesn't apply because the SCC says: in the context of a plan of arrangement, the obligation of the Board is to consider the constituencies other than just the shareholders
    - Constituencies that would include the debenture-holders, the employees, the impact on the environment and the community, etc.
    - In the circumstances, here, there is evidence that a special committee did meet with holders of the debentures to hear their arguments – SCC was satisfied that the interests of the debenture-holders were considered, so they were prepared to rule that the plan of arrangement IS fair
  - **BUT: word to the wise: In Canada, if a court is being asked to issue a fairness opinion on a plan of arrangement, if you can't satisfy the court that you have looked at these other constituencies and their interests, you shouldn't expect that the transaction would get court approval**

  - **Law firms are applying this to takeover bid – they are interpreting this as the duties of directors in any context in which a change of control is inevitable – so not just plan of arrangement or amalgamation but any transaction (including a takeover bid)**
    - Problem with this: this isn't a takeover bid – it's not a situation where a Board and shareholder group, faced with an acquisition and change of control, are deciding in some fashion that they need to consider constituencies other than shareholders
    - This is a plan of arrangement case – where is there the connection to the duties of directors in a takeover context?

- So now: if you're advising a board of directors, and what you're contemplating is a takeover bid, are you entitled, in looking at the options, to look at the interests of debenture-holders and your employees, and the communities in which you operate, OR doesn't Revlon apply?

- There are 2 cases now that say Revlon doesn't apply – Schneider case – it says explicitly in the decision, Revlon is NOT the law in Canada
  - But then you look at that case and that case involved a control family – they weren't looking to sell the company to anybody but after a process, they decided they were willing to sell to Smithfield only (who was the 3rd highest bidder)
  - This was the shareholder group that made that decision – the controlling shareholders
  - Question was then: what does the Board do? Because they have entered into all these standstill agreements with the other bidders – do they waive the standstill for Smithfield to allow it to proceed with its offer?
  - Court says: well, their obligation wasn't to get the best offer – Revlon doesn't apply
  - Their obligation is limited to the circumstances, the fact that there was only one deal – the one deal was the Smithfield deal – it was the only deal the family would support
  - There was evidence that if they didn't support this, the value of the stock would fall back
  - So the Board was fulfilling its obligations by waiving the standstill to allow Smithfield to make its offer in the circumstances of that case

  - **So prof would argue that the ratio of that case didn't include that Revlon is not the law of Canada – it was that Revlon is not applicable to those particular circumstances because the controlling votes/the voting shares rendered it inapplicable**

- SCC decision in BCE in the context of a fairness transaction says Revlon is not the law in Canada – well, they were only addressing a fairness matter – a plan of arrangement which required a decision that the transaction was fair
- They were not considering the obligations of the Board faced with a contest for control, structured as a takeover bid

- SO be cautious about the idea that we are no longer in Revlon mode in Canada when a change of control has become inevitable and that you do have some duty in a takeover bid context to consider all these other constituencies

- Back to SCC:
  - What represents adequate consideration of the interests of the other constituencies? How far do we have to go in worrying about the employees?
    - *If there are 2 bidders – one is a well-capitalized group, one is a less well-capitalized group*
      - *The first one is offering $10/share and you know they can finance it using cash in the company*
      - *The second group is willing to pay $15 but in order to do it, they have to put a lot of leverage in the company and they potentially are going to be firing people and limiting the employment going forward because they have to pay for the transaction*
      - *Could you seriously make a decision that I've considered the constituencies and we're going to go with the $10 deal?*
    - *In the context of the debenture-holders in the BCE case, if there had been anything in the nature of the protection of their interests and if the effect of the plan of arrangement would have been to prejudice that interest, the courts could absolutely have set it aside*
      - *But the court said the debenture-holders could have protected themselves and they did not*
      - *Effectively what they were trying to do was get the court to put in place protections for them that they hand't negotiated for*

    - **SO don't over-read this decision as rewriting the Canadian laws relating to the Board's duties in the face of a takeover bid**

    - ***So what is the final position on this?***

***In the Matter of Magna International Inc* 2010 ON Sec Com**

THE POINT OF THIS CASE:

In BCE, the Supreme Court reviewed and restated the legal principles governing consideration of a proposed plan of arrangement. In this regard, a court must be satisfied that: (i) the statutory procedures have been met; (ii) the arrangement has been put forward in good faith; and (iii) the arrangement is fair and reasonable.

In determining if an arrangement is "fair and reasonable", courts must be satisfied that (a) the arrangement has a valid business purpose, and (b) the objections of those whose legal rights are being arranged are resolved in a fair and balanced way. The corporation bears the onus of satisfying these tests. In Magna's case, there was no serious debate that the first two requirements had been met.

Focussing on the two-prong "fair and reasonable" test, the Magna case represents the first case in which the "valid business purpose" test was at issue. In concluding that this test was met, the courts clarified that a valid business purpose requires only the prospect of clearly identified benefits to the corporation that have a reasonable prospect of being realized if the arrangement is implemented – as opposed to vague and imprecise benefits that are, by their nature, unlikely to be realized.

The courts found that the elimination of Magna's dual class share structure would benefit Magna both from a corporate governance perspective and a financial perspective. In particular, Magna's board of directors would be elected by all the shareholders rather than through the Stronach Trust's control block which would improve responsibility and accountability to shareholders and hence, corporate governance. In addition, there

was the prospect that Magna's cost of capital would decrease. The application judge rejected the submission of the opposing shareholders that Magna was required to demonstrate with sufficient certainty that the benefits of the proposed arrangement (which, being prospective, are necessarily unquantifiable and uncertain) would offset the costs (which are fixed and assured).

Turning to the second prong of the test, the opposing shareholders asserted that because of the uncertain and unquantifiable nature of the potential benefits of the arrangement in contrast to the fixed and assured costs, the court could not make an objective and substantive determination of fairness. The court rejected this argument and concluded that it may find a plan of arrangement to be fair and reasonable notwithstanding the court is unable to make an exact determination or precise calculation of the relative financial costs and benefits of the arrangement. In the context of a shareholder vote, it is enough if there is credible evidence that shareholders could reasonably conclude that the perceived benefits equal or outweigh the costs.

- Not required reading

- The reason this was put in there: good job of explaining how a deal should be put together
- TJ did a good job of explaining what they did

- We talked about business judgment rule – whenever you're deciding a transaction, you're trying to get yourself into the business judgment rule
  - Why?
    - Directors get the protection of the business judgment rule when they make a decision
    - You want that protection because it is a get out of jail free card
    - Rule is (basically): the judge is not going to substitute his discretion for the board's discretion if the board acted within the bounds of reasonableness

- So as a person who drafts the documents, designs the transaction, you always want to have in the back of your mind that you want to keep your board within the bounds of the business judgment rule
- So what do you do: you look at what similarly-situated people do in similar circumstances and you do the same thing that they do
- This case has a long list of what the Magnum board did

- What happened in this case:
  - The Stronack family controlled Magnum – like, really controlled Magnum

  - The share structure
    - Class A shares – 1 vote/share
    - Class B shares – 300 votes/share (had close to ⅔ of the votes)

  - With this kind of disparity, the numbers were crazy:
    - 112,037,893 class A shares
    - 726,829 class B shares – Stronack family

  - So, the Stronacks, with less than 1% of the economic investment (the capital) control ⅔ of the vote

  - The Stronack family decided to wind this up so the Stronack family trust (which owned the shares) approached the company and said, buy us out
    - Because of the huge disparity, and the fact that the non-voting securities were not liquid at all, therefore dragging down the value of the securities (because no one is ever going to make an offer for the non-voting securities)
    - There are no coattails because this company is so old

- So there was no way class A shareholders were ever going to have any assurance that they were going to be able to participate in a takeover because the class B shareholders controlled everything

- The takeover premium inherent in securities: control of the company usually gets purchased for about 35% above the market-value of the securities
  - That 35% was never going to be captured by the class A shares

- So the class B holders were really a drag on the value of the company and the value of the class A shares
- So Stronack wanted to unwind this

- So they went to the Board and said: we'd like to sell
- So the Board created a special committee of independent directors, didn't involve Stronack's people, didn't involve management
- **The independent directors entered into negotiations with the Stronacks through the special committee and they struct a deal:**
  - **The deal: they would cancel the class B shares in exchange for 2 things:**
    - **$300 million in cash**
    - **$9 million in class A shares (7-12% of the shares?)**
    - **Total consideration: $863 million in cash and shars**
    - **There were also family consulting agreements, etc.**

- Everyone freaked out because $863 million represented 12% of the value of the corporation
- So 12% of the value of the corporation was going to go to someone who owned 0.6-0.8% of the corporation

- So someone sued

- **P. 7-108? – goes through the analysis**
  - This whole thing was being done by way of plan of arrangement – so you have to ask yourself what's the test for when a court approves a plan of arrangement (when is it allowed?)
  - **Para 38: SCC in BCE said that determining whether a plan of arrangement is <u>fair and reasonable</u> (that's the test), a court must consider a variety of factors, none of which is conclusive and the relevance of which will vary from case to case based on the facts of the case**
    - When a vote has been held, while the outcome of a vote is not determinative, it is a factor that will receive considerable weight and is a key indication of whether those affected by the plan consider it fair and reasonable
    - Other indicia of fairness identified by the SCC:
      - The proportionality of compromise between the security-holders (para 39)
      - Their position before and after the arrangement
      - The impact of the arrangement on their rights?
    - The courts may also consider the repute of the advisors and endorsers of the plan
      - Ex. If a world-renowned investment banker said the plan is fair, you're allowed to take that into account in determining the plan is fair and reasonable
    - Courts may also consider the approval of the special committee…

    - These are not exhaustive, simply an overview

  - **Then they go through and apply BCE to the facts of this case**
    - First of all, were the statutory requirements met – here, yes they were
      - Look at ON BCA, steps you have to go through to approve plan of arrangement – all met

    - Was the application put forward in good faith?

- Is the proposed plan of arrangement fair and reasonable? – TWO PRONGED TEST
  - 1. Is there a **valid business purpose** by the corporation in respect of the proposed arrangement?
    - Opposing shareholders argued there is no way you can say there is a valid business purpose here because the trial court couldn't say that the 12% of value that was being given to the class B shareholders was value that would accrue to the class A shareholders
    - The court found that this valid business purpose test was met
      - **The valid business purpose isn't *invalidated* because you can't conclusively establish the benefits of the arrangement to the class A shareholders – that it will offset the cost and that the *value* to them is going to be $863 million**
      - **The Magna case represents the first case in which the "valid business purpose" test was at issue. In concluding that this test was met, the courts clarified that a valid business purpose requires only the prospect of clearly identified benefits to the corporation that have a reasonable prospect of being realized if the arrangement is implemented – as opposed to vague and imprecise benefits that are, by their nature, unlikely to be realized.**
      - **This is your test for whether or not there was a valid business purpose: you have to demonstrate the prospect of clearly identified benefits to the corporation that have a REASONABLE prospect of being realized IF the plan is implemented – it doesn't have to be definitive but it has to be reasonable (para 50)**
      - And here we had renowned experts who said YES it was

  - 2. Are the objections of those securityholders whose legal rights are affected by the plan of arrangement being resolved in a fair and balanced way?
    - Question is whether the cost and benefits to the class A shareholders are fairly balanced …. ?
    - Again, they look at what the issue of whether the $863 million is worth it
    - They point out: there was no procedural unfairness
      - They had a right to vote, there was lots of disclosure (p. 57)
      - Status quo is not coercive
      - Coercive is if the situation you would be left with is worse than your situation today

    - BCE requires the court to treat competing interests of the different shareholder classes to be balanced….
      - If the fair… the vote of the shareholders is important evidence of support of finding the proposed arrangement is fair and reasonable
      - Here, the court said: look, its not determinative that the vote in favour means it is fair and reasonable – yes, minority you can still come to the court and complain but you have a major uphill battle if you do

- **Conclusion: they agreed that the fair and reasonable test was met in this case**

US CASES

***Unocal Co v Mesa Petroleum Co* 1985 Del SC**

Facts:

- M attemped front-end loaded, two-tier tender offer
- This would not be permitted in Canada (in this way). The second transaction would require the same consideration. You would also need ⅔ of the shares to effect the second step.
  - *First: the second transaction cannot be part of the first because if it is part of the first, you're going to have to offer the same consideration*
  - *Second: in Canada, in order to do a squeeze-out type transaction, you probably need to have ⅔ of the shares to be able to do that because in the US, a simple majority of the shares is sufficient to be able to*

- *He was proposing to do something here that would be very difficult to do in Canada*

- Selective stock repurchase would also not be permitted in Canada
- BOD determined that the value proposed was inadequate. Even the front-end amount was below fair value. They also determined that the company would buy back a majority of the outstanding shares at a price of between $70-75 per share (substantially better than what M was proposing)
  - *The Board of Directors faced with this offer concluded that the value that was being proposed was inadequate*
  - *It was the opinion of the financial advisor to Unocal that the fair value of the shares of Unocal was $60 each*
  - *So even the offer by Masa was below fair value so they said no, this isn't a fair offer*
  - *They also received an opinion from their financial advisor that the company could afford to buy back the majority of its outstanding shares at a price of $70-75/share*
  - *The company doesn't have to make a bid for everything but they can certainly make an offer for the majority of the stock at $70-75*

- Announces that in the event that M is successful in their bid in the first instance, then the company will buy back all of the remaining shares not held by Mesa for $72/share
  - *So the BoD faced with this offer and with Mesa not proposing to increase the price announces that in the event that Mesa is successful with its bid in the first instance to buy 37% at $54/share, then the company will buy back all of the remaining shares that are not held by Mason at $72/share*
  - *So the company will do a selective stock purchase*

- Mesa was unhappy about this – why?
  - M felt the BOD was acting inappropriately. Believed they were motivated by the improper purpose of entrenching themselves in office.

Decision:

- Business Judgment Rule
- Court will not substitute its judgment for that of the board

Application to Canada:

- <u>Where you have a circumstance where a BOD was motivated to entrench themselves and take steps in favour of supporting a friendly bid, they could go over the line where the business judgment rule would not apply because they failed to show they acted fairly</u>

***Revlon Inc v Macandrews & Forbes Holding* 1986 Del SC**

- Designed to protect themselves against litigation or fail to attain fair value for the company and if you argue it correctly, in the EXAM answer, if you make reference to the SCC decision in the BCE Case

- Revlon defends itself twice against the same bidder (Ron Perlman - Pantry Pride)
- PP approaches Revlon indicating he is interested in purchasing the company. Revlon wants nothing to do with him. Revlon adopts a note purchase rights plan. PP declares a hostile TOB at $47.50/share subject only to the ability to secure financing and redemption of rights plan.
- Revlon board suggests rejection, and commence their own offer to redeem shares for senior notes and convertible stock.
- In order to respond to the initial approach by PP, BOD adopts approach of buying back some of its own stock (common). By buying back the stock they chew up cash or incur debt obligation. They issue notes to former holders of the shares with note protection covenants (1. no additional debt, 2. wont sell assets, 3. restricted dividends on shares). These restrictions are designed to make the notes valuable. They ensure the noteholder that they are ranking clearly in priority to assets disposals and other payments of dividends.
- Initial offer goes away.
- PP comes back with an offer of $50, then $53.

- Revlon now needs to look at different defence mechanisms (mostly limited to a white knight defence).
- Went to a firm that proposed to do a leveraged buyout.
- This is the very action that the BOD was worried that PP would take.
- Clearly then, the motivation is to not have Ron Perlman specifically as the bidder.
- They reached an agreement with the other firm

SHAREHOLDER RIGHTS PLANS

***In the Matter of Canadian Jorex Limited et al* 1992 ON**

- Unpleasant set of facts
- You had a bidder interested in target – the bidder made a bid for 100% of the shares of the target offering a certain number of shares of the bidder
- The Board of the target doesn't like the bid, they adopt a shareholder rights plan to get rid of it – the pill stays in place, the pill is running its course
- And the bidder goes to the securities commission to set aside the defensive tactic (the shareholder rights plan) because it is preventing the shareholders form receiving the bid

- All of a sudden, another bid appears – by CEO of the company – a partial bid
- Any time there is an insider offer
- Any time there is a partial bid – **the partial bid is coercive** – the bid for all isn't
  - *If I make a bid for a company, I'm 13% I make a bid for 37% – I just want control of the company*
  - *And you're a shareholder*
  - *What would you do if my bid was expiring and there wasn't another bid out there?*
  - *Say, shares are trading around $40 – base offer is $54*
  - *You're a shareholder, the bid is expiring, what do you do? – you tender, because if you don't, you'll probably never get the takeover premium because the stock value is going to fall off if he has control, that's why he wants the control*
  - *So if you're ever going to participate in a share premium attached to a change of control of the company, it's in the initial bid*

- So why is the Board of the target company willing to waive the rights plan for its own CEO's competing bid, which is a partial bid, but not allowing the bid by the third party for 100% of the company to go to the shareholders?

- **The decision:**
  - Under the NI, the Commission's job is to decide under the NI, has the time for the pill come and gone?
  - You can have a shareholder rights plan in Canada, but it is simply a matter of time until it goes – there is no permanent pill in Canada
  - It is simply a mechanism to allow the Board additional time to find a defence, to look at other options, etc.

  - When this case came down: effectively, they were saying, we are not going to concern ourselves with the appropriateness of the directors' conduct, we are not going to focus on whether the directors acted in good faith or in the best interest of the company – in this situation where they supported a partial bid by an insider over a 100% bid by a third party, it looks like they are entrenching themselves
  - The facts of the case here suggests that the Board is motivated by an improper purpose

- The trouble with this case: the competing bid they managed to dig up was an insider bid and also a bid for a minority of the shares, which the prof thinks, is a coercive one

- Note: there is a different type of coercion you find in some of the cases and it relates to the minimum condition
  - *I make a bid for 100% of the company and it is a condition of my offer that a ⅔ majority of the shares are tendered*

  - *Because I want the ability to effect a second-stage squeeze out transaction to take the company private afterwards (special resolution)*
  - *What if in the process of my offer, I change my bid to provide that it is going to close on March 5 and I'm going to eliminate my minimum tender condition and I'm only going to take up the shares that are tendered to me at that time*
  - *What you've effectively done is change the dynamic between yourself and the shareholders*
  - *Any shareholder who tenders is assured they're going to have their shares taken up (because there is no minimum condition) and anyone who resists runs the risk that their shares won't be bought at that premium*
  - *So you don't know if the bidder is going to do the second-stage transaction – you could end up finding yourself in a minority in the company with no premium left*
  - *So there is a theory in Canada that a takeover that includes a minimum condition (⅔ type) – a removal of that ⅔ minimum tender condition in the offer represents a form of coercion*

- SO: the Sec Com doesn't really care about the business judgment rule, all they care about is: does the pill have to go?

CW Shareholdings Inc v WIC Western International Communications Ltd 1998 ON

- Remember the Board of WIC which had received a bid by CanWest, already a holder of 35% of the company
- After Jorex case, we go to the WIC case
  - The Board, faced with this bid, at a price of $39/share, says we need time to develop another bidder
  - Tough because any other bidder will want majority control and CW can just say no
  - So Board of WIC, through a special committee with the benefit of independent financial and legal advice, they adopt a shareholder rights plan – it is clear that the SRP is to provide the board additional time and effectively to prevent CW from purchasing any more shares in reliance of that exemption from the takeover bid requirement, which allows you to buy 5% during the tenancy of your bid

  - A week after the adoption of the SRP, a joint hearing of the ON and BC and AB SC kicks the SRP out entirely – says this SRP was adopted after the bid was announced and clearly there is nothing coercive about this offer, this is an inappropriate action of the Board

  - The Board was successful to get someone else to bid

  - But the decision of SC was very surprising

- The reason we reference WIC: there has been some see-sawing in the cases as the Commission leers to one side or the other

Royal Host Real Estate Investment Trust 1999 BC Sec Com

- There was a bidder called the CHIP REID – wants to acquire RH
- RH doesn't like CHIP REID
- Board adopts a unit-holder rights plan – has the effect of preventing the unit-holders from being able to tender to the bid
- The decision goes through a bunch of precedents, starting with Jorex, then you get to a decision
- **This is a decision in BC – BC SC in joint hearing with ON and AB SC:**
  - **They adopt a broadly contextual fact-specific approach:**
    - In the course of the decision, they say, after giving these decisions in the fact patterns upon which they are based, they come to the conclusion that it is fruitless to search for the holy grail of specific tests or series of tests that can be applied in all circumstances
    - Take over bids are fact specific; the relevant factors, and the relative importance to be attached to each, will vary from case to case. As a result, a test that focuses on certain factors to the exclusion

of others will almost certainly be inappropriate in some of the cases to which we attempt to apply it.

- So they get rid of the rigid approach they adopted in WIC and they set out a non-exhaustive list of factors to be considered in determining whether it is time for the pill to go
  - 1. Whether the SRP was approved by the shareholders
  - 2. When it was adopted – was it in the face of the bid, prior to the bid, after the bid?
  - 3. Whether there is broad shareholder support for continued operation of the plan
    - You will find in some cases, majority of the SHs say we want the pill to remain
  - 4. The size and complexity of the target corporation – if its a complex business, obviously that will take more time for them to find other potential bidders
  - 5. 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
  - 6. The number of potential viable offerors
    - If there are a number of offerors, the SC will be motivated to not let the pill stand
  - 7. Steps taken by the target corporation to find an alternative bid or transaction that would be better for the shareholders
    - If the Board, faced with an offer, is now aggressively going to the market to try to find a competing bid, they are trying to get an auction – and if you read 62-202, the Sec regulators have said that they like auctions – they think they're the best way to adduce fair value
  - 8. The likelihood that, if given further time, the target corporation will be able to find a better bid or transaction
    - If the evidence is that we have confidentiality agreements in place with several parties, 2 parties are trying to arrange financing, etc. – commission will take this into account because they want the competing bid to come forward
  - 9. The nature of the bid, including whether it is coercive or unfair to the shareholders of the target
  - 10. Length of time since the 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.
  - 11. Likelihood that the bid will not be extended if the SRP is not terminated.
    - In some of the cases, you find, the bidder (the first one) never says, in response to questions, that I won't extend my bid – when they fail to do that, the SC has become somewhat suspicious that they're really trying to get the Commission to kill a pill and end the auction to allow their first in the queue offer to get to the shareholders
    - Whereas, if you're really want to win the bid, you're better of saying we don't intend to extend and we don't intend to offer a higher price – at that point, the SC will say, why are we leaving this in place? If we leave it in place, we're going to deny shareholders the ability to accept their offer

- So we have the original decision in Jorex, then crazy WIC decision, now this non-exhaustive list of factors – we have a state of law in Canada that seems to lack coherence as to how the SC will rule

- We get to an AB case and a ON case – decision is rendered where the pill is allowed to stay
- Going back to Jorex: they say, look, it's a question of time – it's not a matter of whether the pill will go – its a matter of when
- Suddenly these 2 cases: Neo and the Pulse Data seem to suggest that the SRP could stay – and appear to imply that in Canada, maybe the just say no defence will be successful – maybe we are trending back to American type

***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 Sec Com
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.
- <u>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.</u>
- 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.

Lecture Notes:
- Involving mining assets
- There was a company named Noranda? – big Canadian mining company
- Another company called Falconbridge
- They merged or some shit and 15% of the shares they sold went to a company named Xstrata – larger mining company
- Then they buy another 4.9% – end up at **19.9%** the largest shareholder of Falconbridge
- Xstrata wants to buy Falconbridge
- Board of Falconbridge wasn't interest – in part because they had been talking to another company called Inco – they wanted to merge and create a world class company headquartered in Canada involved in mining of all different types
- They strike an agreement for a long-term strategy
- Requires competition approval in Canada, antitrust approval in the States – this takes a long time to get
- A year goes by – in that year, Inco and Falconbridge continue to trade at different prices and Xstrata is still interested in acquiring BUT they had given deal protection to Falcobridge – so they wait until the weekend after that deal protection deal had fallen away
- It so happens that Teck made its own independent offer for Inco
- Teck was saying to Xstrata – we'll go for Inco, you go for Falconbridge – but Xstrata didn't agree, they didn't want to tie themselves up
- Teck makes an offer for Inco, Xstrata makes an offer for Falconbridge
- Now both those companies are being put in play

- But by this point, in Canada, we have 62-202 and they say we better come up with a better offer
- They go to a group called Phelps Dodge and they propose a 3-way merger of Phelps, Falconbridge and Inco
- Another shareholder comes along named Valet? from Brazil – and makes a bid for Inco, beats Teck
- So Inco is bought by Valet

- Xstrata is sitting there trying to buy Falconbridge – makes a takeover bid, Falconbridge is defending but Xstrata looks like its going to win – largest single shareholder Strata? is unhappy because Falconbridge adopts a shareholder rights plan – doesn't let them buy any more shares
- They go to the Commission – they want to have the shareholder rights plan removed because what they would like to do is be able to buy 5% of the shares of Falconbridge under that exemption in their offer (the only way you can buy shares when you make a takeover bid is pursuant to the bid unless you include in the bid one exception and that exception is: you can buy up to 5% of the shares in the market at the market price provided it is not higher than the bid price, provided you disclose the purchases, etc – announce your intention and then disclose when you make the purchase)

- **The Board of Falconbridge goes to OSC and says, look you can't get rid of the shareholder rights plan and you cannot allow Xstrata to buy any shares in reliance on that exemption because any competing bidder is going to be very interested in getting a special majority and if Xstrata gets up to 25%, the ability of anybody to get to a special majority is going to be much more difficult – so you need to grant an order denying them the ability to rely on that exemption and only permit them to buy the shares upon the successful completion of the bid**
- **OSC agrees with the board of falconbridge**

- Troubling decision from prof's perspective:
  - 1. The SC is amending, by denying access to an exemption, an exemption that clearly exists in the Act – the takeover bid code allows you to buy up to 5% without violating the law (remember chapter 4)
    - What is different about this case than the legislative intent that created those rules in the first place? Why deny the ability of a bidder who happens to be under 20, who makes a takeover bid, who has pre-announced for months to be able to buy 5% pursuant to their takeover bid
    - Prof thinks the OSC got this one wrong
    - Why did they decide to do this? They were motivated by 62-202 – so 62-202 is causing them to take away exemptions that exist under the law because they believe if they allow them to do it, that would be an action, not a defensive tactic, but an action that would make it less likely that a takeover bid for Falconbridge could be launched even thought legislative intent would have said: well that would have been clear for anybody – why would you provide the exemption if you were going to take it away

***In the Matter of Pulse Data Inc* 2007 AB Sec Com**

- They permit a SRP to continue thereby preventing an unsolicited bid from proceeding even though sufficient time had passed for a competing bid to come forth and even though the target company acknowledged that maintaining the rights plan was not directed at gaining time to seek out alternative bidders.

- In rendering the decision to leave the pill in place, the AB SC attached a great weight to a shareholder meeting held after the bid was launched and only a week before the hearing, at which holders of 75% of the company's outstanding shares voted in favour of maintaining the SRP
- In voting to maintain the SRP, the AB SC held that the shareholders had made an informed decision – they noted that among the extraordinary amount of information the shareholders had been provided in connection with the bid, was that the Pulse Board is highly confident in the future of Pulse Data and the continued success of its business plan
- Having chosen to allow the Board to just say no to the bid, the AB SC strictly deferred to the business judgment decision of the Pulse Board, stating it was reluctant to interfere with the Board's decision given its fiduciary duty to act in the best interest of the shareholders, particularly when that decision had been recently approved by informed shareholders

- But the facts in this case are arguably very unusual:
  - A bid is made for the company, the bid is at a premium
  - After the bid is launched, an SRP is adopted

  - A shareholders' meeting is convened by the management of the company
  - The shareholders are given all kinds of information about the bid, about the company, why the Board is recommending rejection of the bid, and the shareholders by a 75% vote, vote in favour of keeping the pill – in most situations, you couldn't convene a shareholders meeting that quickly
  - But in this particular circumstance, its not just that the directors didn't want to go with the bid, the shareholders didn't
  - The business judgment of the directors had been validated by the shareholders

Neo Material Technologies Inc and Pala Investments 2009 ON Sec Com

- The OSC appears to have approved the reasoning in the AB case and suggests that an SRP is an appropriate response in the face of an unwelcome bid
- The OSC decision was significantly influenced by a shareholder vote to approve the SRP in question and by a desire to show appropriate deference to the exercise of business judgment by Neo's Board

- Neo went further than Pulse, suggesting that even in the absence of a real possibility of an auction, the public interest may lie in allowing the target Board to just say no to an unwelcome bid – wow – so now the SC is articulating that a just say no defence appears to be possible in Canada

- SO: a theme: SC will defer to shareholder approval of director's business judgment

- Facts:
  - Pala already held 20% of Neo's shares, launches a partial bid for a further 20% – later amends the bid, so they're only going for 10% more?
  - Neo has a RP in place when Pala's bid is commenced but subsequently adopts a second tactical RP designed to thwart their ability to complete a creeping takeover bid
  - A significant majority of Neo's shares voted to retain the second tactical RP and the OSC inferred that the Neo shareholders, by voting to retain the second RP, were rejecting the Pala bid notwithstanding the absence of any indication of a competing bid
  - In reaching that decision, the OSC notes that although one purpose of the RP is to allow the target company to pursue alternative value-enhancing transactions, that was not their only legitimate purpose
  - Specifically, the OSC relying upon the SCC decision in BCE, regarding the business judgment rule, holds that the RP could be used for the broader purpose of protecting the long-term interests of the shareholders
  - OSC goes on to find that it was evident that in the view of the Neo Board, avoiding auction was in the long-term best interest of the corporation and the shareholders as a whole
  - Accordingly, the OSC concluded that it was not time to cease trade the RP based upon the reasonable business judgment of Neo's Board and that the RP was being used to protect the long-term interests of the company

- So the range of justifications for maintaining a RP has now been extended by the Neo case in particular
  - When a Board of Directors is able to produce evidence that they are focused on the long-term business plan and that the long-term business plan is going to produce better results than this unfairly low offer that has come along
  - Prof thinks they are advantaged in the Neo case by the fact that the bid that they were defending against was a partial bid, initially for 20% then reduced to 10%
    - Why? Because inherently, partial bids are somewhat coercive

- SO: it appears that maybe the law in Canada is changing

Icahn v Lions Gate Entertainment Corporation 2010 BC Sec Com

- In response to an unsolicited takeover bid by Icahn

- They render a decision in the context of a SRP

- The BC SC, having received an argument about Neo and Pulse Data, which were non-competitive bid situations, and that it was possible to just say no, the BC SC expresses reservations about those precedents
- They centered upon the inherent departure in those decisions from the Canadian securities commissions' view of the public interest as it relates to rights plans and all prior decisions
- The BC SC basically says that they do not regard those two cases as being a precedent and that they could be limited to their own facts
- The principal basis of the decision in Lions Gate is the view traditionally expressed by Canadian securities regulators: the rights plan should not deprive shareholders of the opportunity to respond to a bid by tendering into it
- In keeping with that view, the reasons of the SC reiterate a number of principles traditionally identified by the Canadian securities administrators in determining the public interest as it relates to the continuation of a SRP

- The observation by the BS SC that any reluctance of regulators to interfere with a target Board of the discharge of its fiduciary duties in the face of an unsolicited bid is tempered by the need to protect the public interest by ensuring that shareholders ultimately have the opportunity to decide whether or not to tender into the bid

- So you have the AB and ON case
- The next case that comes along is this case
  - Icahn is the only bidder for LG
  - LG is trying to argue: don't get rid of the pill, we have the power to just say no to this bid and the BC SC is having none of that
  - Says: NO

***In the Matter of Baffinland Iron Mines Corporation* 2010 ON Sec Com**

- Baffinland is a junior mining company engaged in exploration of mineral property in Nunavut
- Nunavut Iron Ore Acquisition Company – a Canadian private company is formed for the sole purpose of going after Baffinland
- They commence an unsolicited takeover bid to acquire all of the outstanding shares for $0.80? in cash
- They end up extending their offer from Sep 22 to Nov 22
- On Nov 8, Baffinland announces it has entered into a support agreement with ArcelorMittal, one of the world's leading steel companies, pursuant to which AM makes an offer to acquire all of the outstanding shares of Baffinland for $1.10 in cash and certain outstanding common share purchase warrants for $0.10 in cash
- AM commences its friendly takeover bid on Nov 12 – the earliest date at which they can take up the shares is Dec 20 (35 days later) – one month after the scheduled expiry of the Nunavut offer
- Holders of approx. 26% of the outstanding Baffinland common shares enter into a lockup agreement with AM
- Baffinland adopted an amended SRP in January 2009, which was approved by the shareholders in March 2009 – 18 months prior to the commencement of Nunavut's offer
- The support agreement with AM required Baffinland to waive the SRP immediately prior to the expiry of the AM offer or earlier if requested by AM
- So, effectively, they are trying to take away the timing advantage that Nunavut would have had
- Nunavut appeals to the OSC for an order cease-trading the SRP
- OSC grants the order and cease-trades the Baffinland SRP
- **Consistent with the principles outlined in National Policy 62-202 and those enunciated in the majority decision in the BC Sec Com decision in Lions Gate regarding the importance of shareholders having the opportunity to decide whether to tender to the bid, the OSC concluded that the Baffinland shareholders should determine the outcome of the two competing bids**

- You find the OSC trying to reconcile its decision with the earlier Neo case
- The OSC states that its decision to cease-trade the SRP, and not to do it in Neo, was based on the fact that shareholders had overwhelmingly approved the RP in the face of the specific bid, that it had been put to shareholders with time to vote
- However, the OSC concludes that it would defer to the decision shareholders expressed by that vote… and it goes on to explain why it examined the board's fiduciary duties ..

- Having concluded that it would defer to the wishes of the Neo shareholders, and not cease-trade the SRP, the Commission had asked whether there were any circumstances that would lead it to a different conclusion
- One such consideration was whether or not the Board of Neo was acting in accordance with its fiduciary duties in having decided not to solicit competing bids
- If the Board was not complying with its fiduciary duties, then that might have led the Commission to cease-trade the Neo SRP regardless of the shareholder vote although whether the Commission would have done so is an open question

- **The OSC then states that Neo does *not* stand for the proposition that the OSC will defer to the business judgment of the Board of Directors in considering whether to cease trade the SRP or that a Board, in exercising its duties, may just say no**
- So they seemed to have stepped way back from the Neo case

- The OSC goes on to state:
  - Neo suggests only that **whether or not the board of directors of a target issuer is acting in the best interests of that issuer and its shareholders, and is complying with its fiduciary duties, <u>is a relevant, although secondary</u>, consideration** for the Commission in deciding whether to cease trade a rights plan. Whether a board of directors is complying with its fiduciary duties does not *determine* the outcome of a poison pill hearing.

- Other facts and circumstances that the OSC considered in deciding that granting the cease trade order was in the public interest included that
  - 1. The rights plan had accomplished the objective of stimulating an auction (i.e., there were two competing offers on the table)
  - 2. The rights plan should not be permitted to be used for the purpose only of eliminating a timing advantage available to Nunavut as the first bidder
  - 3. Immediately cease trading the rights plan could potentially result in a higher offer from Nunavut
  - 4. The Nunavut offer was not inherently coercive as a result of a minimum tender condition
  - 5. It was unlikely that Nunavut could acquire sufficient common shares to frustrate the auction, and
  - 6. The terms of the support agreement cannot restrict the OSC's ability to act in the public interest.

- So for those people who were arguing that the Neo and Pulse Data reflect a shift in Canada to the US standards, you now have the Baffinland case that says: that isn't what we meant at all
- In the circumstances here, where an auction has come forward, we are not satisfied that we should honor the Neo decision and leave the pill in place

Fibrek and Resolute Forest Products 2012 QC Sec Com

- In 2012, a case in QC arose involving an unusual set of facts relating to both a shareholder rights plan and the duties of directors in the face of a takeover bid: November 2011

- RFP in Nov 2011 advises the Board of a company, Fibrek, that RF plans to make a cash takeover bid for Fibrek
- Nov 28: press release is issued announcing its intention
- It was also disclosed that RF had entered into a hard lock-up agreement with 3 different shareholders of Fibrek, including FairFax Financial, which was the largest shareholder at 25.5% – under which, those

shareholders, holding about 50.7% of Fibrek's issued and outstanding shares would agree to tender their shares into the offer by RF

- The lock-up agreements were described as hard lock-ups
  - *Hard vs. soft lock-up agreements: soft is where you agree to tender the shares into my offer but if another offer comes along, you can withdraw from that commitment and tender to the better bid*
  - *Hard: you agree to tender your shares into my offer and you can't get them back*

- Its an unusual circumstance because Resolute, the bidder, approaches Fibrek and says, we're prepared to make a bid at $1/share and we have lock-up agreements with 50.7% – it seems almost inevitable that a change of control is going to occur because they have this huge amount of locked-up stock

- What does the Board of Directors at Fibrek do?
  - If you believe that Revlon rules *are* applicable, that when a change of control becomes inevitable, then you would say that your obligation is to try to go out and find a better bid – but how do you convince a bidder to come along when the competing bid (the first bid) already has 50.7% of the shares locked up?
  - How do I find a better opportunity for my shareholders?
    - SRP – you adopt one, gives you more time
    - Make the majority not the majority anymore

- So the Board at Fibrek finds a competing bidder in a company named Mercer
  - Mercer had approached FairFax long before – at the time, FairFax pushed them away
  - FairFax, it turns out, is a shareholder of Resolute – in fact, 2 of the 3 major shareholders are shareholders of Resolute
  - So they've signed a hard lock-up agreement and they are shareholders of the bidder
  - It almost sounds like they are joint actors – it's arguable that they are joint actors
  - So the Board of Fibrek, faced with this situation, and Mercer being prepared to make an offer at a 30% premium, agree to do a series of things:
    - 1. SRP
    - 2. Amend the employment agreements of all the senior officers of the company to give them golden parachutes
    - 3. Then in order to induce Mercer to come up with its competing bid, they issue a special warrant to Mercer, giving Mercer the ability (at a $1/share) to buy 20% of the then-outstanding 20% of the shares of the company
      - The effect of this transaction is to reduce the locked-up share percentage from 50.7% to something in the 30-40% range

- What are the duties of the directors? – you know that a change in control is inevitable because 50.7% has already hard locked-up to sell

- The matter goes to the QC Sec Com
  - **Re SRP:** the RP has to go – the Resolute offer has to go to the shareholders – so basically follows the traditional line of cases including Lions Gate
  - **Re changing of the employment agreements:** no one seems to get too excited about that but somehow it taints the board of directors
  - **Re the granting of the securities through an option agreement to the preferred bidder:** NO: the effect of that transaction was to undercut the bid – we think what you're basically doing is preferring another bidder
    - There is no evidence about a pre-existing relationship between Mercer and Fibrek
    - You're trying to take away control from Resolute to create an unbalanced control situation

- The matter gets appealed to SCC – SCC doesn't hear the case

- Prof thinks that:

- The hard lock up agreements entered into, there is an interlocking shareholding relationship between the hard locked-up shareholders and the bidder – if a different panel of the SC heard this case (or the OSC for example), there might be a different result
- Because what else could they do? The result here would have been either:
  - Mercer would have proceeded with its $1.30/share offer (30% premium) or Resolute would have had to raise their bid
  - So the directors, if they're charged with the responsibility of finding the best price

- Fibrek is really the first case, by the way it was decided, that suggests that Revlon is not the law in Canada – it doesn't always follow that in the context of a change of control, the Board of Directors can do anything it needs to get a competing bid
- And maybe it's that they can't issue shares – that is the one line you can't cross
- But in this case, short of issuing shares, there was nothing to do

RESTRICTED VOTING SHARES

TSX Manual 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

Example of Coattails

- P. 713 – two examples:
  - *First one: coattails*
    - **Section 2: if an exclusionary offer is made, each outstanding subordinate shall be convertible into one multiple voting share at the option of the holder during the conversion period**
      - Remember the prohibition: unless an offer is made to everybody – exclusionary offer is defined as an offer to purchase the multiple voting shares that must, by reason of applicable securities regulation, be made to all holders of multiple voting shares – and it is not concurrently made to an offer to purchase the subordinate voting shares on the same terms (called an exclusionary offer),
    - **The conversion period is the period of time commencing on the 8th day after the offer is made and terminating on the expiry date**

      - Takeover bid made on day 1 (exclusionary offer)
      - On day 35, the takeover bid is over
      - Conversion period starts on day 8

    - **If the conversion right is actually exercised, …**

    - **Section 3: (cleanup clause) it all converts back if things don't turn out the way you want**
      - **An exercise of …**

    - If you elect to convert, an election shall also be <u>deemed</u> to constitute an irrecoverable election by the holder to **<u>deposit</u>** the converting shares pursuant to the exclusionary offer …
      - *Basically says: if you're going to convert, you actually have to tender to the offer*
      - *When you deposit, you also have a withdrawal right (so you can withdraw and tender to a better offer if it comes along)*

    - Second part: you are deemed to exercise
      - *Basically says: you're deemed to put the shares back into subordinate if either (a) you withdraw your securities or (b) the offeror doesn't take up the securities*

    - **Section 4:** *making clear that you're not going to get multiple shares out there in the wild – so you're not issuing share certificates to anyone, you're only going to print them and deliver them to the offeror on behalf of the shareholder who has tendered*

    - **Section 5:** *this allows you to: the majority holders can stall for time – so if I give notice on day 28 give you notice that I'm going to accept this offer, I give you 7 days for the conversion to occur*
      - Why would you do this? Because you want to think about it
      - OR within the 7 days after the offer, the majority delivers notice that they are not taking the offer

    - Section 7: they have to provide notice – also have to put out a press release and put out a notice to the shareholders (in case notice is slow)

- Coattails are not common in Vancouver (because they're not common in mining), not common in Calgary (because they're not common in oil and gas) – but really common in Toronto (because its common in manufacturing companies coming out of family holdings)

- P. 718? Trust agreement with John Smith for ABC Company and XYZ Trust Company
  - Same thing – coattails
  - Where the securities aren't public
  - The agreement you need – the second category of coattails

  - Important: note: this is an agreement with John Smith – John Smith holds 50% of the multiple voting shares – you need to have 80% to have an effective coattails agreement

Example of an Information Circular (Okanagan)

- This is an example of an information circular that you would use if you're going to create a restricted share structure
- Section 7
- Changing a bunch of shit
- **What they're doing is setting up a structure that has multiple voting shares and subordinate voting shares, so everyone is going to get the 10-vote shares and the 1-vote shares**
- **You set this up so that going forward, as you do share offerings, you can raise capital by issuing the class B securities, not the class A securities**
- **And as you issue more of the class A securities, you don't dilute the class B voting power**

- In order to be effected, **special resolutions** must be effected by the following:
  - Not less than ¾ of the votes cast by the members at the AGM AND pursuant to TSX policies, by a <u>majority</u> of the members at the AGM that *exclude* those cast by holders of securities held by:
    - Insiders (owns 10% or more, directors, officers)
    - Any person who owns, directly or beneficially, securities of 20% or more
    - Those who alone, or in concert with others, effectively control the company

  - Votes: 100%
  - 20% are insiders
  - 80% held by everybody else

    - If you need majority of minority, you need 50%+1 of the 80% = **40%+1**
    - You also need 66⅔%
      - 66⅔% – 20% = from the group, you need **46⅔% –** so you still need majority of the minority
      - So it doesn't matter

  - **P. 735** – description of the multiple and subordinate voting shares
    - Extensive
    - Talks about a whole bunch of shit

    - Dividends: entitled to participate equally
    - <u>**Conversion**</u>**:** this is where you start to get into the part about coattails

      - Drag-along provision – if majority of multiple shareholders vote in favour, then everyone has to come along

    - Takeover bid provision (the one required by TSX)

Saunders v Cathton Holdings Ltd 1997 BCCA

- All about interoperation of coattails
- WIC had 2 classes of common shares:
  - Voting and non-voting
  - The non-voting shares were listed on the TSX and had coattails added to them as part of the listing process
- From 1994, Cathon took a run at WIC, which had a majority block-holder WBC
- WBC wasn't very thrilled with Cathon's offer
- **Eventually they struck a deal that had Cathon increase its stake – didn't get as many shares as it wanted but it ended up with more shares in the company because Cathon made a private agreement with WBC to purchase a substantial block of WIC's voting shares**
- And that transaction was at a price in excess of the current market price of the publicly traded non-voting shares
- At the end of the day, WBC ended up holding 62.2% of the voting shares and Cathon's holdings increased from 11.6% to 28.9%
- At all times, WBC held over 50% of WIC's voting shares
- So after the transaction was completed, question came up as to whether or not the conversion rates in the coattails for the non-voting shares was tripped
  - Did the non-voting shareholders, as a result of this transaction being entered into, have the right to convert their shares and participate in the transaction?
  - Because WBC was paid more than market for the securities they sold to Cathon

- The coattails were in place before the transaction

- P. 743 – description of how this works?
  - Fairly typical coattail though a little more sparse than the modern version of it – but the modern version was written after this case

- Para 10 of the decision – if an offer, as defined in article 8 is made, then each holder of class B non-voting shares shall be entitled at any time, from time to time, to have all or a part of the class B non-voting shares held by him converted into fully paid, non-assessable? class A voting shares …. on a 1:1 conversion ratio
  - *Simple*
  - *But it comes down to: if an offer is made*
  - *The entire point of this case*

- Definition of "offer" (p. 744) – **question came down to whether or not this was an offer**
  - *So: an offer is an offer to purchase a number of securities that if the offeror, Cathton, acquires them, means that they, in connection with anyone they are acting jointly or in concert with, will own more than 50%*
  - *So look at the numbers: the offer here ended up in them owning 28.9% BUT were there joint actors?*
    - **The argument is that WBC was acting jointly or in concert with Cathton**

- **Question was: was this an offer under the definition of the coattails**
  - A lot of this case comes down to whether or not there's anything that really matters about the phrase **"jointly or in concert with the offeror as such term is construed for purposes of the Ontario Securities Act"**
    - First of all: it doesn't say Ontario Securities Act "as amended from time to time"
      - "as amended from time to time" is an important drafting convention put into agreements – if you don't have it after a reference to a statute or any other kind of third party document, you're arguably saying that it's the Securities Act <u>as it existed as of the date of this agreement</u>

- There is an attractiveness to this argument because why would you think that subsequent amendments to the Sec Act would help you interpret this agreement when the drafters of this agreement had no idea what the Sec Act would look like at that point?

- *Example: if you reference GAAP without saying "as amended from time to time," you don't pick up IFRS – if you don't define GAAP as "the accounting principles that are generally accepted in Canada as approved by the Canadian Institute for Chartered Accountants" then you don't pick up IFRS*

- Here, if it existed through time, there was some language in the Sec Act that got amended which would have cast this whole agreement in a different light

- **If you look at the Sec Act, it defines "acting jointly or in concert" very broadly because they don't want any monkey business – they want it to capture as wide a group as possible because**

- Question here was: should that broad concept get imported into this document

- Court said: NO
  - They said, okay yes, it is "acting jointly or in concert" as defined in the Sec Act BUT clearly, they couldn't have meant the term to be as broad as it is in the Sec Act because they have language in the beginning of the sentence that says "an offer means an offer to purchase or the acceptance of an offer to sell"
  - So the offeror did not accept an offer to sell – the act that the offeror was doing was not the acceptance of an offer to sell
  - If you're going to get WBC involved with Cathton (put them together because they are acting jointly or in concert), the court said, the action has to be the same action – but what Cathton is doing is offering to purchase, it is not accepting an offer to sell
  - **So if you want WBC to be part of that same group, i.e. to be acting jointly or in concert with Cathleen, they have to be acting the same way –** a very narrow interpretation

  - Because WBC wasn't acting the same way that Cathton was, it wasn't acting jointly or in concert, therefore you couldn't lump them together, therefore, Cathton only owned 29%, therefore it wasn't over the 50% threshold, therefore the conversion rights weren't triggered

INSIDER TRADING

BCSA s. 1(1): "insider"

"insider" means**:**

(a) a director or an officer of an issuer (*basically a company*)

(b) a director or an officer of a person that is itself an insider or a subsidiary of an issuer (*ex. a director of company B, which is a 10% shareholder of company A, would be an insider of company A*)

(c) a person that has:

(i) beneficial ownership of, or control or direction over, directly or indirectly, or

(ii) a combination of beneficial ownership of, and control or direction over, directly or indirectly, securities of an issuer carrying more than 10% of the voting rights attached to all the issuer's outstanding voting securities, excluding, for the purpose of the calculation of the percentage held, any securities held by the person as underwriter in the course of a distribution,

(d) an issuer that has purchased, redeemed or otherwise acquired a security of its own issue, for so long as it continues to hold that security,

(e) a person designated as an insider in an order made under section 3.2 (*catchall: if you're deemed by the securities administrators to be an insider, you are one*), or

(f) a person that is in a prescribed class of persons (*don't worry about this*)

BCSA s. 1(1): "material change"

"**material change**" means:

(a) if used in relation to an issuer other than an investment fund,
- (i) 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
- (ii) a decision to implement a change referred to in subparagraph (i) made by
  - (A) the directors of the issuer, or
  - (B) senior management of the issuer who believe that confirmation of the decision by the directors is probable, and

(b) if used in relation to an investment fund,
- (i) a change in the business, operations or affairs of the investment fund that would be considered important by a reasonable investor in determining whether to purchase or continue to hold a security of the investment fund, or
- (ii) a decision to implement a change referred to in subparagraph (i) made
  - (A) by the directors of the investment fund or the directors of the investment fund manager,
  - (B) by senior management of the investment fund who believe that confirmation of the decision by the directors is probable, or
  - (C) by senior management of the investment fund manager who believe that confirmation of the decision by the directors of the manager is probable;

BCSA s. 1(1): "material fact"

"**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;]

BCSA s. 3: "special relationship"

A person is in a "**special relationship**" with an issuer if that person:

(a) is an insider, affiliate or associate of
- (i) the issuer,
- (ii) a person that is proposing to make a take over bid, as defined in section 92, for the securities of the issuer, or (*so if you are proposing to acquire a company*)
- (iii) a person that is proposing
  - (A) to become a party to a reorganization, amalgamation, merger, arrangement or similar business combination with the issuer, or
  - (B) to acquire a substantial portion of the property of the issuer,

(b) is engaging in or is proposing to engage in any business or professional activity with or on behalf of the issuer or with or on behalf of a person described in paragraph (a) (ii) or (iii),

(c) is a director, officer or employee of the issuer or of a person described in paragraph (a) (ii) or (iii) or (b),

(d) knows of a material fact or of a material change with respect to the issuer, having acquired the knowledge while in a relationship described in paragraph (a), (b) or (c) with the issuer, or

(e) knows of a material fact or of a material change with respect to the issuer, having acquired the knowledge from another person at a time when
- (i) that other person was in a special relationship with the issuer, whether under this paragraph or any of paragraphs (a) to (d), **and**
- (ii) the person that acquired knowledge of the material fact or material change from that other person knew or reasonably ought to have known of the special relationship referred to in subparagraph (i).

Example

People in a special relationship with Issuer A:
- **Directors and officers of Issuer A** (s. 3(a)(i) + definition of "insider")
- **Holders of 10% or more shares (Company B)** (s. 3(a)(i) + definition of "insider")

  - Directors and officers of Company B (definition of "insider")
  - Holders of 10% or more shares of Company B – ??
- **Acquirer Co.** (s. 3(a)(ii) or (iii))
  - Directors and officers, etc. of Acquirer Co. (s. 3(c))
  - Holders of 10% or more of Acquirer Co. – ??
- **Anyone who found out the material fact/change while in a relationship described above** (s. 3(d))
- **Anyone who found out the material fact/change *from a person* who is in a relationship described above** AND he ought to have known of the special relationship (s. 3(e))

BCSA s. 57.2: insider trading, tipping and recommending

(1) In this section, "issuer" means
(a) a reporting issuer, or
(b) any other issuer whose securities are publicly traded.

(2) A person **must not enter into a transaction** involving a security of an issuer, or a related financial instrument of a security of an issuer, 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, which material fact or material change 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 with respect to the issuer 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 of a security of the issuer.

BCSA s. 57.3: front-running

(1) In this section:

"**investor**" means a person
(a) who has indicated an intention to purchase or trade a security or an exchange contract, or
(b) for whose account an order is or would be placed;

"**material order information**" means information that relates to
(a) the intention of an investor to purchase or trade a security or an exchange contract, or
(b) one or more unexecuted orders,

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;

"**order**" means an order to purchase or trade a security or an exchange contract.

(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 or a person referred to in paragraph (a) or (b),
  (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 – *so they know that an investor is about to acquire shares*
  (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).

DEFENCES

BCSA s. 57.4: Defences

(1) A person does not contravene section 57.2(2) (*insider trading, tipping and recommending – entering into a transaction*) if, at the time the person enters into the transaction involving the security, exchange contract or related financial instrument, the person reasonably believes that the other party to the transaction knows of the material fact or material change.

(2) A person does not contravene section 57.2 (3) or (4) (*insider trading, tipping and recommending – informing another person*) 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 or material change.

(3) A person does not contravene section 57.2 (2) (*insider trading, tipping and recommending – transaction*) or 57.3 (3) (*front-running – transaction*) if the person
  (a) enters into the transaction under a written automatic dividend reinvestment plan, written automatic purchase plan or other similar written automatic plan, in which the person agreed to participate before obtaining knowledge of the material fact, material change or material order information, or
  (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.

Note: Dividend Reinvestment Plan** (**DRIP**):* *When a company gives their dividends to their shareholders, as a shareholder, you can opt to either get the cash or you can enter into these DRIP plans, which take the dividend amount and invest them back into the company.* ***Key is: *if it is an automatic receipt of securities and it's predictable, then you have this defence.* ***NB: Option plans*** *may not fall under this because you're not automatically entitled to them, it's at the discretion of the Board. But if you could argue it should fall under an automatic plan if you always get them and it is basically automatic.*

(4) A person does not contravene section 57.2 (2) or 57.3 (3) if the person entered into the transaction
(a) as agent under the specific unsolicited instructions of the principal, – *if you're a broker and your client gives you instructions to acquire the shares without you saying anything (coincidental)*
(b) as agent under specific instructions that the agent solicited from the principal before obtaining knowledge of the material fact, material change or material order information, – *if you're a broker and you act on your client's instruction before you got this material information*
(c) as agent or trustee for another person because of that other person's participation in a written automatic dividend reinvestment plan, written automatic purchase plan or other similar written automatic plan, or – *if you're acting as a broker under any of these automatic plans*
(d) as agent or trustee for another person to fulfill a written legal obligation of the other person.

(5) A person that is not an individual does not contravene section 57.2 (2) or (5) or 57.3 (3) or (5) (*insider trading or front running – transaction or informing/encouraging*) 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 section 57.3 (3) if, at the time the person enters into the transaction, the person reasonably believes that
(a) the investor has consented to the person entering into the transaction, and
(b) the other party to the transaction knows of the material order information.

(7) A person does not contravene section 57.3 (4) if, at the time the person informs the other person of the material order information,
(a) the person reasonably believes that the investor has consented to the person informing the other person, and
(b) the person informs the other person that both the person and the other person are connected to the investor for the purposes of section 57.3.

(8) A person does not contravene section 57.3 (5) if, at the time the person recommends or encourages the other person to enter into a transaction,
(a) the person reasonably believes that the investor has consented to the person recommending or encouraging, and
(b) the person informs the other person
(i) of the material order information, and
(ii) that both the person and the other person are connected to the investor for the purposes of section 57.3.

LIABILITY FOR INSIDER TRADING

BCSA s. 136: Liability for insider trading, tipping and recommending

(1) If an issuer, or a person in a special relationship with an issuer, contravenes section 57.2 (*the insider trading rules*), 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.

BCSA s. 136.2: Due diligence defence 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.

INSIDER REPORTS

BCSA s. 87: Initial and subsequent insider report

(1) In this section, "reporting issuer" does not include a mutual fund. *so you're only dealing with reporting issuers/public companies*
(2) An insider of a reporting issuer must, in accordance with the regulations,
  (a) file reports disclosing the insider's
    (i) beneficial ownership of, or control or direction over, directly or indirectly, securities of the issuer, and
    (ii) interest in, or right or obligation associated with, a related financial instrument of a security of the issuer, and
  (b) make other prescribed disclosure.

BC Securities Rules s. 158: Early report by control person

If a control person (*someone holding over 10% of the shares*) files a report under section 137 the control person is not required to file a report under section 87 of the Act.

BC Securities Rules s. 137: Reports by control person of a reporting issuer

(1) If a control person of a reporting issuer distributes a security under an order issued under section 76 (1) of the Act, the control person must file a report in the form required under section 87 of the Act on or before the 3rd day after the distribution.
(2) On application by a control person of a reporting issuer or on the commission's or executive director's own motion, the commission or executive director, if the commission or executive director considers that to do so would not be prejudicial to the public interest, may order that section 137 (1) does not apply to a trade, intended trade or control person or class of trades, intended trades or control persons.

BCSA s. 1 definitions: "control person"

(a) a person who holds a sufficient number of the voting rights attached to all outstanding voting securities of an issuer to affect materially the control of the issuer, or
(b) each person in a combination of persons, acting in concert by virtue of an agreement, arrangement, commitment or understanding, which holds in total a sufficient number of the voting rights attached to all outstanding voting securities of an issuer to affect materially the control of the issuer,

and, if a person or combination of persons holds more than 20% of the voting rights attached to all outstanding voting securities of an issuer, the person or combination of persons is deemed, in the absence of evidence to the contrary, to hold a sufficient number of the voting rights to affect materially the control of the issuer;

BC Securities Rules s. 159: Filing in other jurisdictions

(1) Subject to subsection (2), if the laws of the jurisdiction in which the reporting issuer carries on business or in which the reporting issuer was incorporated, organized or continued require substantially the same reports in that jurisdiction as are required by section 87 of the Act, the filing requirements of section 87 of the Act are satisfied by filing the reports which are required by the laws of the other jurisdiction and which are signed or certified as set out in section 189.

(2) Subsection (1) does not apply to insiders that are required to file insider reports in electronic format under National Instrument 55-102 System for Electronic Disclosure by Insiders (SEDI).

BCSA s. 183: Lieutenant Governor in Council regulations

The Lieutenant Governor in Council may make regulations for the purpose of regulating trading in securities or exchange contracts, or regulating the securities industry or exchange contracts industry, including regulations as follows:

(19) respecting any matter necessary or advisable to carry out effectively the intent and purpose of Part 12, including, but not limited to,
- (i) requiring any person or class of persons to comply with Part 12 or any provision of it,
- (ii) prescribing how a security or class of securities of a reporting issuer, or a related financial instrument or class of related financial instruments of a security of a reporting issuer, must be reported in an insider report filed under section 87,
- (iii) prescribing standards for determining when a material fact or material change has been generally disclosed;
- (iv) prescribing procedures for the integration of the disclosure required under Part 9 with that required under Part 12 including modifying or varying the application of this Act as may be necessary for the purpose of permitting integrated disclosure, and
- (v) prescribing different classes of requirements for different classes of persons;

NI 55-104 INSIDER REPORTING REQUIREMENTS AND EXEMPTIONS

s. 1.1(1): "reporting insider"

"**reporting insider**" means an insider of a reporting issuer if the insider is:
(a) the **CEO, CFO or COO** of the reporting issuer, of a significant shareholder of the reporting issuer or of a major subsidiary of the reporting issuer;
(b) a **director** of the reporting issuer, of a significant shareholder of the reporting issuer or of a major subsidiary of the reporting issuer;
(c) a person or company responsible for a principal business unit, division or function of the reporting issuer;
(d) a **significant shareholder** of the reporting issuer;

(e) a significant shareholder based on post-conversion beneficial ownership of the reporting issuer's securities and the CEO, CFO, COO and every director of the significant shareholder based on post-conversion beneficial ownership;
(f) a management company that provides significant management or administrative services to the reporting issuer or a major subsidiary of the reporting issuer, every director of the management company, every CEO, CFO and COO of the management company, and every significant shareholder of the management company;
(g) an individual performing functions similar to the functions performed by any of the insiders described in paragraphs (a) to (f);
(h) the reporting issuer itself, if it has purchased, redeemed or otherwise acquired a security of its own issue, for so long as it continues to hold that security; or
(i) any other insider that
  (i) in the ordinary course receives or has access to information as to material facts or material changes concerning the reporting issuer before the material facts or material changes are generally disclosed; and
  (ii) directly or indirectly exercises, or has the ability to exercise, significant power or influence over the business, operations, capital or development of the reporting issuer;

s. 1.1(1): "significant shareholder"

"significant shareholder" means a person or company that has beneficial ownership of, or control or direction over, whether direct or indirect, or a combination of beneficial ownership of, and control or direction over, whether direct or indirect, securities of an issuer carrying more than 10 per cent of the voting rights attached to all the issuer's outstanding voting securities, excluding, for the purpose of the calculation of the percentage held, any securities held by the person or company as underwriter in the course of a distribution;

s. 3.1: Reporting requirement

An insider must file insider reports under this Part and Part 4 in respect of a reporting issuer if the insider is a reporting insider of the reporting issuer.

s. 3.2: Initial report

A reporting insider must file an insider report in respect of a reporting issuer, within 10 days of becoming a reporting insider, disclosing the reporting insider's
(a) beneficial ownership of, or control or direction over, whether direct or indirect, securities of the reporting issuer, and
(b) interest in, or right or obligation associated with, a related financial instrument involving a security of the reporting issuer.

s. 3.3: Subsequent report

A reporting insider must within five days of any of the following changes file an insider report in respect of a reporting issuer disclosing a change in the reporting insider's
(a) beneficial ownership of, or control or direction over, whether direct or indirect, securities of the reporting issuer, or
(b) interest in, or right or obligation associated with, a related financial instrument involving a security of the reporting issuer.

s. 3.4: Reporting requirements in connection with convertible securities

For greater certainty, a reporting insider who exercises an option, warrant or other convertible or exchangeable security must file, within five days of the exercise, separate insider reports in accordance with section 3.3 disclosing the resulting change in the reporting insider's beneficial ownership of, or control or direction over, whether direct or indirect, each of
(a) the option, warrant or other convertible or exchangeable security, and

(b) the common shares or other underlying securities.

- *What does this mean? – if you* ***acquire options****, you disclose that in your insider report; if you* ***exercise your options****, you also have to disclose that*
- *If you* ***acquire a warrant*** *to acquire shares, you have to disclose then, and then if you decide to* ***exercise your warrants*** *(or a portion), that is a reportable event as well*

- There are exemptions for things such as normal course issuer bids (Part 7)
  - *So if a company acquires shares of itself, it's obviously not going to be required to file insider reports*
  - *Mutual funds have exemptions*
  - *Generally, exemptions to insider reporting requirements are pretty rare – most people don't fall under them*

Superintendent of Brokers v Pezim, Page, and Ivan **1994 SCC**

What amounts to a "material change"?

Elements of definition: (a) the change must be in relation to the affairs of an issuer, (b) the change must be in the business, operations, assets or ownership of the issuer, and (c) the change must be "material", *i.e. it would reasonably be expected to have a significant effect on the market price or value of the securities*.

Changes in assay/drilling results *can* amount to a material change; new information relating to a mining property (which is an asset) bears significantly on the question of that property's value (***Pezim*** **1994 SCC**).

The identity of a single (insider) purchaser for a private placement, which could result in a significant increase in the placee's control over the company is a **material change** and must be disclosed (***Pezim*** **1994 SCC;** ***held:*** *the identity of the placee (Prime) and the fact that Prime (an insider) would its control over Calpine from 23 to 36%, assuming exercise of the warrants, should have been disclosed;* ***note:*** *today, this would also get caught by insider reporting requirements*).

A negative event, such as an underwriter dropping out of a transaction, constitutes a material change and is a disclosable event (***Pezim*** **1994 SCC;** *company did not accurately disclose withdrawal of ALC from financing*).

- Marie Pezim was the sort of godfather of sketchy mining companies back in the day – he ran a company called Prime, an umbrella company that controlled 50 or so junior public companies
- It was an extremely inbred scene back then + lack of regulation = a lot of people profiting from information not available to the public

- Pezim and his associates (LP and JI)
- Prime is the umbrella company, Pezim, LP and JI were principals of the company called Prime
- They were accused of 3 violations
  (1) Failure to disclose positive drill results; these positive drill esults were disclosed immediately after options were granted to the principals of Prime
  (2) Being offside a private placement of one of the companies that they held shares in – they did not disclose that Prime (the purchaser of the shares in the private placement)
  (3) They did not accurately disclose the withdrawal of ALC, which was a bank back in the day that had initially agreed to be part of a financing and pulled out of the financing – the company did not publicly disclose this fact

- The facts:
  - Pezim, Page and Ivany were principals of Prime Resources Company (the umbrella organization)
  - Calpine was one of the entities that Prime had a stake in (20% or something like that)
  - **On 4 separate occasions**, the company was accused of issuing news releases with positive drill results that came out right after the grant of options – and these options were going to principals of Prime

- Why is this a problem?
  - *Day 1: option are granted*
  - *Day 2: positive press release – this causes the share price to go up*
  - *When you issue options, today the exchange rules say, you cannot issue options with an exercise price that is lower than the closing price the day before the options are issued*

  - *So lets say the shares are trading at $1.25 on day 1, if you want to grant options on day 2, the exercise price cannot be lower than $1.25*
    - *Why would you want it to be lower? If you're granting 100 options to acquire 100 shares at a price of $0.75/share*
    - *If the shares are trading at $1.25 and I exercise at $0.75/share, then I make a 50% profit immediately*
    - *So the rule says, you cannot make the exercise price less than the closing price on the day before the options are granted*

  - *If you issue your news release on day 1 – share price goes from $1.25 to $1.50 because the results are positive*
    - *Then on day 2, if you want to issue your options, now you have to issue them at $1.50*
    - *So it is in their interest (the option grantees) to get their options granted before positive material information is introduced into the marketplace*

- This happened on 4 separate occasions – positive results came out right after the grant of options

- Pezim and his crew's defence: they had Chinese walls in place – they had their geological team

- **The Commission found that willful blindness is not a defence**
  - You have a positive obligation to make inquiries to determine whether there has been a material change prior to engaging in any securities transaction – and this applies to management
  - So as a D or O of a company that is getting options, you have a positive obligation to inquire

  - So they found willful blindness is not a defence for management teams

  - They found that Calpine was in breach because they were in possession of material information/facts/ changes but they did not disclose them – clearly were withholding it until they were able to grant options, then they disclosed the information
  - So they were withholding material facts/material changes

  - BUT the Commission found that because of these Chinese walls, Pezim wasn't actually in contravention of what the equivalent of the insider trading rule is today – because he didn't know – they weren't actually trading on any information, they just got their options, they weren't privy to the actual information itself
  - **So they were found to be offside the requirement to disclose material facts/changes but not on the actual insider trading on that information**

- **BCCA overturned the Commissions finding:**
  - There is no positive obligation – drill results do NOT constitute material changes, they're just results,
    - *Prof: which you could argue is true – but you still have an obligation – the literal interoperation of the court's ruling is correct: that you don't have a positive obligation to disclose material FACTs, but when taken as a whole as far as the system that was set up and the fact that these guys were clearly willfully blind to the whole thing, it didn't pass the smell test*
    - *And drill results, if they change the share price, they're material facts, they should be disclosed and there should be a positive obligation on them*

- And that's what the SCC found

- The SCC decision talks about how they ultimately decided to give deference to the Sec Com since the SC, unlike the courts, are actually in the business of regulating insider trading – they ultimately deferred to that

- **<u>This was the first finding: the takeaway from the first part of the case: there is a positive obligation on management to inquire prior to entering into any securities transactions</u>**

- The second allegation: they had improperly proceeded with a private placement – or they had withheld material information/facts in the course of a private placement
  - *Private placement: in short, when a public company wants to issue shares, they have to do it by way of prospectus UNLESS you fall under one of the exemptions to the prospectus requirements*
  - *One of the exemptions is the private placement exemption – most common way: accredited investor exemption – basically that if you're really really rich, you don't need the benefit/protection of a prospectus*

- So in this case, Calpine was going to raise money by way of a private placement – so they issued a news release
- On July 14, they announced a private placement for 2 million units (unit: a bundling mechanism consisting of 1 share + 1 warrant to acquire shares) – they disclosed this BUT the problem was: they DID NOT disclose that there was only one purchaser for the shares
  - *Normally when you do a private placement, you sell to about 50 different purchasers*

- In this case, the purchaser was Prime
  - Prior to the placement, Prime held a 23% equity interest
  - After the 2 million units pursuant to the private placement, they went up to 36% interest

- So first of all: if this happened today, there are insider reporting requirements

- But not only did they not discloses this, they announced the closing of the private placement on August 18, but then they subsequently issued a press release in December that they had received the funds
  - So the shares were issued on Aug 18
  - But the funds only hit Calpine's account in December
    - *Aside: what is the issue with this?*
      - *If this happened today, under the BCA, shares need to be fully paid – you cannot issue shares unless they are fully paid*
      - *So they were offside in that respect as well – this is not covered in the case*

  - But the real issue is: they announced a private placement for $2 million but they didn't disclose that there was only one purchaser, and further that it was an insider

- The Commission found this to be failure to disclose a material change
- CA agreed
- SCC upheld

- 3rd allegation: with respect to withdrawal of one of the underwriters to a separate financing
  - In September 1989, Prime made a public offering (*means they are issuing the units to the public, has to be by way of prospectus – at least, today*) of 5 million units at $4.25/unit under a guaranteed agency agreement

  - *Aside: difference between agency agreement and underwriting agreement?*
    - *When you do a financing, when a company wants to issue shares, they can do it 3 ways:*
      - *By itself – go out and sell if to whoever wants them*

- *Or it can engage a dealer – dealers will either be either:*
  - *Agents or*
  - *Underwriters*

  - *When you see a financing deal on a **best-efforts basis**, that's an agency deal – the agent is saying we will do our best efforts to sell these shares*
    - *We're going to enter into this agency agreement, we're going to sell $100 million worth of shares*
    - *If they succeed, great*
    - *If they don't, there is no liability (other than reputation)*

  - *And underwriting agreement is what they call a **bought-deal**? – the underwriters have committed to buy the $100 million in shares from the company on the closing date*
    - *If they don't have purchasers, the underwriters are on the hook for it*

- *So a "guaranteed agency agreement", it is probably basically an underwriting agreement*

- So in September 1989, Prime entered into this guaranteed agency agreement to sell $5 million units – these agreements are generally entered into between the company and a few banks
  - In this situation, they had multiple underwriters, one of them was ALC bank
  - The closing was September 29
  - On September 25, ALC advised the lead underwriter for the deal that they were dropping out
    - Peter Brown (a director of the lead underwriter and also a director of Prime; there was also a director of ALC who was also a director of Prime)
    - So someone from ALC called Prter Brown
    - Peter Brown called Pezim, said, listen, we're out too (Canicord)

  - So on September 29, neither ALC nor Canicord paid for their shares

  - It took until October 19 for Prime to issue a press release – and it only said that Canicord was dropping out, it didn't say anything about ALC
  - Eventually, Canicord proceeded with the financing, but ALC did not

- The Commission saw the failure to announce that an underwriter who was responsible for 25% of the deal had dropped out
- This is a material fact/change – and it needs to be disclosed
- There was no insider trading but the Commission held that that was a failure to disclose material information

- The BCCA did NOT view this as a material change, but the SCC overturned the CA and gave ultimate discretion to the SecCom who found that they were in violation for failure to disclose a material change

- **SO: 3 things to take away from this case:**
  - **There is a positive obligation on management, D&O to make inquiries as to whether or not there is a material change/fact that hans't been disclosed prior to entering into a securities transaction**
  - **For the private placement, the existence of a single purchaser for a private placement is a material fact, which needs to be disclosed**
    - **Under today's rules, this would also get caught by the insider reporting requirements – so on EXAM: you would want to mention that insider reporting requirements would cover this today**
  - **Lastly, a negative event, such as an underwriter dropping out of a transaction constitutes a material change and is a disclosable event**

R v R Bennett, H Doman, and W Bennett 1989 BCPC

- Horse-trading case
- Doman and Bill Bennett owned a race horse together
- In short, there was clear insider trading in this case
- There is evidence of Doman, who is president of the company, calling Bill Bennet, his buddy, in advance of negative information being announced
- There is evidence of Bennett selling his shares in advance of the announcement of the material undisclosed negative information
- But these guys swear that they were talking about their horses

- Facts:
  - Louisiana Pacific and Doman had been in negotiations with respect to a possible transaction involving – LP was potentially going to acquire Doman
  - There were tonnes of rumours about a takeover – and when there are rumours about a takeover, when a company becomes a target, that causes their share price to go up (because when you're a target, you're going to get acquired, usually, at a premium around 30-35% of your current trading price)
  - LP engaged Canadian counsel
  - They went for dinner on August 24 – the president of Doman and the president of LP to discuss the potential transaction
  - LP met with RBC, who was a major shareholder of Doman
    - *So when you're going to acquire someone, first thing you do is talk to management of the target – you'll need shareholder support so if there is a 10% shareholder, you want to talk to these guys – you need support of major shareholders*

  - On September 20, 1988, Doman issued a news release in which they announced an intention to negotiate a possible transaction with LP
  - On October 7, the parties entered into a term sheet whereby LP agreed that they would acquire Doman for a price of $12/share
    - *When doing a friendly deal, companies will always enter into a term sheet or letter of intent, before actually entering into the definitive agreement*
    - *Normally: first step is to talk and negotiate, then they enter into an LOI or term sheet –*
    - *They agree in this term sheet, that in 15/30/60 days, they're going to enter into a definitive agreement (merger agreement or plan of arrangement)*

    - *Reasons for doing this:*
      - *It gives the acquirer 30 days to do their due diligence*
      - *It's non-binding*
      - *It also gives them exclusivity – it prevents the target from going out and seeking a third party acquirer*

    - *Also: common practice is that you wouldn't press release an LOI – because they want to keep it confidential and maintain the integrity of their pricing and also its not binding*
  - The term sheet expired on Oct 30 – so during that time, LP did their due diligence
    - On Oct 30, they came to the conclusion that it was not in their interest to proceed with the transaction
    - And in the meantime, there are all these rumours that these guys are going to be a takeover target and the share price goes up
    - On Oct 30, Doman asked for more time – they asked for another week, but said at this time we can't recommend proceeding with the transaction

  - On November 4 at 9.52 am, the president of LP called Billman to tell him that the deal was off
    - That phone call went from 9.52 am – 10.07 am
    - Bennett, who owns a horse with Doman owned 7 million shares in Doman

        - Bennett's brother was in the same situation but owned less shares

    - There is evidence that there was a phone call from someone in Doman's office to someone at Bennett's office at 10.09 am

    - It was established that around 10.10 am there was a phone call from Bennett's office to Bennett's broker's office and that its broker testified that Bennett told him to sell his entire share position

  - Basically, up until November 4, share price was going up on speculation that the deal was going to close, then at 10.07 am, when Doman hung up the phone, the deal was off – but no one knew, it wasn't publicly disclosed information
  - But as soon as it became publicly disclosed information, you knew that the share price was going to go down
  - And Bennett instructed his broker to sell his shares at 10.10 am

  - Normal course: if we were advising Doman, as soon as there is material information/fact/change, which this was, we would tell them to impose a trading halt, issue a press release and then let trading be reestablished – because you don't want sketch-bags like Bennett to benefit from this

  - What happened though: Doman claimed that he was in a state of shock and did not issue a halt until 11 am
  - When it came to it, evidence of these phone conversations, Bennett and Doman claimed they were talking about their horse

- **The judge held that all of the actions of Bennett were consistent with those of a reasonable trader who had gambled in the interest of trying to achieve a capital gain and that everyone was acting in good faith because there was no evidence that the conversation in question was about the transaction**

- **Takeaway from this case: it is a high standard to prove that you were actually in possession of material non-public information – it needs more than just the existence of phone calls – you need to actually prove – there is a high burden**

***R v Felderhof* 2007 ON (*Bre-X case*)**
- Their chief geologist manipulated samples in what was supposed to be the biggest gold mine in the world, somewhere in south america
- It turned out that they had been taking all these samples and sprinkling them with gold dust – so it was vastly exaggerated, the gold content of these samples they were taking from the soil
- It was all a total scam
- And back then, mid 90s, there were no requirements for mineral exploration or mineral reserves or mineral resources
- So you could go to the public and say you had this amount of ounces and its going to be worth this amount of dollars and the public would either decide to trust you or not trust you – as a result of Bre-X, the SecComs have introduced **43-101 Standards for Mineral Disclosure** – now if you want to say that you have mineral resources or mineral reserves, you need to follow these standards
  - You need a qualified person (certified, professional geologist) to go to the site itself and visually observe the sampling, etc.
  - This is the legacy of Bre-X

- This guy sold $47 million worth of shares

MI 61-101 PROTECTION OF MINORITY SECURITY HOLDERS IN SPECIAL TRANSACTIONS

PART 1: Definitions

s. 1.1: "collateral benefit"

"**collateral benefit**", for a transaction of an issuer or for a bid for securities of an issuer, means any benefit that a related party of the issuer is entitled to receive, directly or indirectly, as a consequence of the transaction or bid, including, without limitation, an increase in salary, a lump sum payment, a payment for surrendering securities, or other enhancement in benefits related to past or future services as an employee, director or consultant of the issuer or of another person, regardless of the existence of any offsetting costs to the related party or whether the benefit is provided, or agreed to, by the issuer, another party to the transaction or the offeror in the bid, but does not include

(a) a payment or distribution per equity security that is identical in amount and form to the entitlement of the general body of holders in Canada of securities of the same class,

(b) an enhancement of employee benefits resulting from participation by the related party in a group plan, other than an incentive plan, for employees of a successor to the business of the issuer, if the benefits provided by the group plan are generally provided to employees of the successor to the business of the issuer who hold positions of a similar nature to the position held by the related party, or

(c) a benefit, not described in paragraph (b), that is received solely in connection with the related party's services as an employee, director or consultant of the issuer, of an affiliated entity of the issuer or of a successor to the business of the issuer, if
- (i) the benefit is not conferred for the purpose, in whole or in part, of increasing the value of the consideration paid to the related party for securities relinquished under the transaction or bid,
- (ii) the conferring of the benefit is not, by its terms, conditional on the related party supporting the transaction or bid in any manner,
- (iii) full particulars of the benefit are disclosed in the disclosure document for the transaction, or in the directors' circular in the case of a take-over bid, and
- (iv)
  - (A) at the time the transaction is agreed to or the bid is publicly announced, the related party and its associated entities beneficially own or exercise control or direction over less than one per cent of the outstanding securities of each class of equity securities of the issuer, or
  - (B) if the transaction is a business combination for the issuer or a bid for securities of the issuer,
    - (I) the related party discloses to an independent committee of the issuer the amount of consideration that the related party expects it will be beneficially entitled to receive, under the terms of the transaction or bid, in exchange for the equity securities beneficially owned by the related party,
    - (II) the independent committee, acting in good faith, determines that the value of the benefit, net of any offsetting costs to the related party, is less than five per cent of the value referred to in sub-clause (I), and
    - (III) the independent committee's determination is disclosed in the disclosure document for the transaction, or in the directors' circular in the case of a take-over bid;

s. 1.1: "connected transaction"

"**connected transactions**" means two or more transactions that have at least one party in common, directly or indirectly, other than transactions related solely to services as an employee, director or consultant, and
(a) are negotiated or completed at approximately the same time, or
(b) the completion of at least one of the transactions is conditional on the completion of each of the other transactions;

s. 1.1: "independent committee"

"**independent committee**" means, for an issuer, a committee consisting exclusively of one or more independent directors of the issuer;

s. 1.1: "independent director"

"**independent director**" means, for an issuer in respect of a transaction or bid, a director who is independent as determined in section 7.1;

s. 1.1: "independent valuator"

"**independent valuator**" means, for a transaction or bid, a valuator that is independent of all interested parties in the transaction, as determined in section 6.1;

s. 1.1: "market capitalization"

"**market capitalization**" of an issuer means, for a transaction, the aggregate market price of all outstanding securities of all classes of equity securities of the issuer, the market price of the outstanding securities of a class being

(a) in the case of equity securities of a class for which there is a published market, the product of
  (i) the number of securities of the class outstanding as of the close of business on the last business day of the calendar month preceding the calendar month in which the transaction is agreed to or, if no securities of the class were outstanding on that day, on the first business day after that day that securities of the class became outstanding, so long as that day precedes the date the transaction is agreed to, and
  (ii) the market price of the securities at the time referred to in subparagraph (i), on the published market on which the class of securities is principally traded, as determined in accordance with subsections 1.11 (1), (2) and (3) of Multilateral Instrument 62-104 Take- Over Bids and Issuer Bids, and in Ontario, subsections 1.3 (1), (2) and (3) of Ontario Securities Commission Rule 62-504 Take-Over Bids and Issuer Bids,

(b) in the case of equity securities of a class for which there is no published market but that are currently convertible into a class of equity securities for which there is a published market, the product of
  (i) the number of equity securities into which the convertible securities were convertible as of the close of business on the last business day of the calendar month preceding the calendar month in which the transaction is agreed to or, if no convertible securities were outstanding or convertible on that day, on the first business day after that day that the convertible securities became outstanding or convertible, so long as that day precedes the date the transaction is agreed to, and
  (ii) the market price of the securities into which the convertible securities were convertible, at the time referred to in subparagraph (i), on the published market on which the class of securities is principally traded, as determined in accordance with subsections 1.11 (1), (2) and (3) of Multilateral Instrument 62-104 Take-Over Bids and Issuer Bids, and in Ontario, subsections 1.3 (1), (2) and (3) of OSC Rule 62-504 Take-Over Bids and Issuer Bids, and

(c) in the case of equity securities of a class not referred to in paragraph (a) or (b), the amount determined by the issuer's board of directors in good faith to represent the fair market value of the outstanding securities of that class;

s. 1.1: "minority approval"

"**minority approval**" means, for a business combination or related party transaction of an issuer, approval of the proposed transaction by a majority of the votes as specified in Part 8, cast by holders of each class of affected securities at a meeting of security holders of that class called to consider the transaction;

PART 2: Insider Bids

s. 1.1: "insider bid"

"**insider bid**" means a take-over bid made by
- (a) an issuer insider of the offeree issuer,
- (b) an associated or affiliated entity of an issuer insider of the offeree issuer,
- (c) an associated or affiliated entity of the offeree issuer,
- (d) a person described in paragraph (a), (b) or (c) at any time within 12 months preceding the commencement of the bid, or
- (e) a joint actor with a person referred to in paragraph (a), (b), (c) or (d);

"**issuer insider**" means, for an issuer
- (a) a director or senior officer of the issuer,
- (b) a director or senior officer of a person that is itself an issuer insider or subsidiary entity of the issuer, or
- (c) a person that has
  - (i) beneficial ownership of, or control or direction over, directly or indirectly, or
  - (ii) a combination of beneficial ownership of, and control or direction over, directly or indirectly, securities of the issuer carrying more than 10% of the voting rights attached to all the issuer's outstanding voting securities

s. 2.1: Application

(1) This Part applies to a bid that is an insider bid.
(2) This Part does not apply to an insider bid in respect of which the offeror complies with National Instrument 71- 101 The Multijurisdictional Disclosure System, unless persons whose last address as shown on the books of the offeree issuer is in Canada, as determined in accordance with subsections 12.1(2) to (4) of that instrument, hold 20 per cent or more of the class of securities that is the subject of the bid.

s. 2.2: Disclosure

(1)The offeror shall disclose in the disclosure document for an insider bid
(a) the background to the insider bid,
(b) in accordance with section 6.8, every prior valuation in respect of the offeree issuer that has been made in the 24 months before the date of the insider bid, and the existence of which is known, after reasonable inquiry, to the offeror or any director or senior officer of the offeror,
(c) the formal valuation exemption, if any, on which the offeror is relying under section 2.4 and the facts supporting that reliance, and
(d) the disclosure required by Form 62-104F2 Issuer Bid Circular of Multilateral Instrument 62-104 Take-Over Bids and Issuer Bids, and in Ontario, Form 62-504F2 Issuer Bid Circular of OSC Rule 62-504 Take-Over Bids and Issuer Bids, to the extent applicable and with necessary modifications.

(2) The board of directors of the offeree issuer shall include in the directors' circular for an insider bid
(a) disclosure, in accordance with section 6.8, of every prior valuation in respect of the offeree issuer not disclosed in the disclosure document for the insider bid
(i) that has been made in the 24 months before the date of the insider bid, and
(ii) the existence of which is known, after reasonable inquiry, to the offeree issuer or to any director or senior officer of the offeree issuer,
(b) a description of the background to the insider bid to the extent the background has not been disclosed in the disclosure document for the insider bid,
(c) disclosure of any bona fide prior offer that relates to the offeree securities or is otherwise relevant to the insider bid, which offer was received by the issuer during the 24 months before the insider bid was publicly announced, and a description of the offer and the background to the offer, and
(d) a discussion of the review and approval process adopted by the board of directors and the special committee, if any, of the offeree issuer for the insider bid, including a discussion of any materially contrary view or abstention by a director and any material disagreement between the board and the special committee.

s. 2.3: Formal Valuation

(1) The offeror in an insider bid shall
(a) obtain, at its own expense, a formal valuation,
(b) provide the disclosure required by section 6.2,
(c) include, in accordance with section 6.5, a summary of the formal valuation in the disclosure document for the insider bid, unless the formal valuation is included in its entirety in the disclosure document, and
(d) comply with the other provisions of Part 6 applicable to it relating to formal valuations.
(2) An to
independent committee of the offeree issuer shall, and the offeror shall enable the independent committee
(a) determine who the valuator will be,
(b) supervise the preparation of the formal valuation, and
(c) use its best efforts to ensure that the formal valuation is completed and provided to the offeror in a timely manner.

s. 2.4: Exemptions from Formal Valuation Requirement

(1) Section 2.3 does not apply to an offeror in connection with an insider bid in any of the following circumstances:
(a) Lack of Knowledge and Representation – neither the offeror nor any joint actor with the offeror has, or has had within the preceding 12 months, any board or management representation in respect of the offeree issuer, or has knowledge of any material information concerning the offeree issuer or its securities that has not been generally disclosed,
(b) Previous Arm's Length Negotiations -– all of the following conditions are satisfied:
(i)the consideration per security under the insider bid is at least equal in value to and is in the same form as the highest consideration agreed to with one or more selling security holders of the offeree issuer in arm's length negotiations in connection with
(A) the making of the insider bid,
(B) one or more other transactions agreed to within 12 months before the date of the first public announcement of the insider bid, or
(C) a combination of transactions referred to in clauses (A) and (B),
(ii) at least one of the selling security holders party to an agreement referred to in clause (i)(A) or (B) beneficially owns or exercises control or direction over, or beneficially owned or exercised control or direction over, and agreed to sell
(A) at least five per cent of the outstanding securities of the class of offeree securities, as determined in accordance with subsection (2), if the person that entered into the agreement with the selling security holder beneficially owned 80 per cent or more of the outstanding securities of the class of offeree securities, as determined in accordance with subsection (2), or
(B) at least 10 per cent of the outstanding securities of the class of offeree securities, as determined in accordance with subsection (2), if the person that entered into the agreement with the selling security holder beneficially owned less than 80 per cent of the outstanding securities of the class of offeree securities, as determined in accordance with subsection (2),
(iii) one or more of the selling security holders party to any of the transactions referred to in subparagraph (i) beneficially own or exercise control or direction over, or beneficially owned or exercised control or direction over, and agreed to sell, in the aggregate, at least 20 per cent of the outstanding securities of the class of offeree securities, as determined in accordance with subsection (3), beneficially owned, or over which control or direction was exercised, by persons other than the person, and joint actors with the person, that entered into the agreements with the selling security holders,
(iv) the offeror reasonably believes, after reasonable inquiry, that at the time of each of the agreements referred to in subparagraph (i)
(A) each selling security holder party to the agreement had full knowledge and access to information concerning the offeree issuer and its securities, and
(B) any factors peculiar to a selling security holder party to the agreement, including non-financial factors, that were considered relevant by that selling security holder in assessing the consideration did not have the

effect of reducing the price that would otherwise have been considered acceptable by that selling security holder,
(v) at the time of each of the agreements referred to in subparagraph (i), the offeror did not know of any material information in respect of the offeree issuer or the offeree securities that
(A) had not been generally disclosed, and
(B) if generally disclosed, could have reasonably been expected to increase the agreed consideration,
(vi) if any of the agreements referred to in subparagraph (i) was entered into with a selling security holder by a person other than the offeror, the offeror reasonably believes, after reasonable inquiry, that at the time of that agreement, the person did not know of any material information in respect of the offeree issuer or the offeree securities that
(A) had not been generally disclosed, and
(B) if disclosed, could have reasonably been expected to increase the agreed consideration,
(vii) the offeror does not know, after reasonable inquiry, of any material information in respect of the offeree issuer or the offeree securities since the time of each of the agreements referred to in subparagraph (i) that has not been generally disclosed and could reasonably be expected to increase the value of the offeree securities;

(c) Auction – all of the following conditions are satisfied:
(i) the insider bid is publicly announced or made while
(A) one or more bids for securities of the same class that is the subject of the insider bid have been made and are outstanding, or
(B) one or more proposed transactions are outstanding that
(I) are business combinations in respect of securities of the same class that is the subject of the insider bid and ascribe a per security value to those securities, or
(II) would be business combinations in respect of securities of the same class that is the subject of the insider bid, except that they come within the exception in paragraph (e) of the definition of business combination and ascribe a per security value to those securities,
(ii) at the time the insider bid is made, the offeree issuer has provided equal access to the offeree issuer, and to information concerning the offeree issuer and its securities, to the offeror in the insider bid, all offerors in the other bids, and all parties to the proposed transactions described in clause (i)(B),
(iii) the offeror, in the disclosure document for the insider bid,
(A) includes all material information concerning the offeree issuer and its securities that is known to the offeror after reasonable inquiry but has not been generally disclosed, together with a description of the nature of the offeror's access to the issuer, and
(B) states that the offeror does not know, after reasonable inquiry, of any material information concerning the offeree issuer and its securities other than information that has been disclosed under clause (A) or that has otherwise been generally disclosed.
(2) For the purposes of subparagraph (b)(ii) of subsection (1), the number of outstanding securities of the class of offeree securities
(a) is calculated at the time of the agreement referred to in clause (b)(i)(A) or (B) of subsection (1), if the offeror knows the number of securities of the class outstanding at that time, or
(b) if paragraph (a) does not apply, is determined based on the information most recently provided by the offeree issuer in a material change report, or section 5.4 of National Instrument 51-102 Continuous Disclosure Obligations, immediately preceding the date of the agreement referred to in clause (b)(i)(A) or (B) of subsection (1).
(3) For the purposes of subparagraph (b)(iii) of subsection (1), the number of outstanding securities of the class of offeree securities
(a) (b)
is calculated at the time of the last of the agreements referred to in subparagraph (b)(i) of subsection (1), if the offeror knows the number of securities of the class outstanding at that time, or
if paragraph (a) does not apply, is determined based on the information most recently provided by the offeree issuer in a material change report, or section 5.4 of National Instrument 51-102 Continuous Disclosure Obligations, immediately preceding the date of the last of the agreements referred to in subparagraph (b)(i) of subsection (1).

PART 3: Issuer Bids – NOT ON EXAM

PART 4: Business Combinations (Going Private)

s. 1.1: "business combination"

"**business combination**" means, for an issuer, an amalgamation, arrangement, consolidation, amendment to the terms of a class of equity securities or any other transaction of the issuer, as a consequence of which the interest of a holder of an equity security of the issuer may be terminated without the holder's consent, regardless of whether the equity security is replaced with another security, but does not include

- (a) an acquisition of an equity security of the issuer under a statutory right of compulsory acquisition or, if the issuer is not a corporation, under provisions substantially equivalent to those comprising section 206 of the CBCA,
- (b) a consolidation of securities that does not have the effect of terminating the interests of holders of equity securities of the issuer in those securities without their consent, through the elimination of post-consolidated fractional interests or otherwise, except to an extent that is nominal in the circumstances,
- (c) a termination of a holder's interest in a security, under the terms attached to the security, for the purpose of enforcing an ownership or voting constraint that is necessary to enable the issuer to comply with legislation, lawfully engage in a particular activity or have a specified level of Canadian ownership,
- (d) a downstream transaction for the issuer, or
- (e) a transaction in which no person that is a related party of the issuer at the time the transaction is agreed to
  - (i) would, as a consequence of the transaction, directly or indirectly acquire the issuer or the business of the issuer, or combine with the issuer, through an amalgamation, arrangement or otherwise, whether alone or with joint actors,
  - (ii) is a party to any connected transaction to the transaction, or
  - (iii) is entitled to receive, directly or indirectly, as a consequence of the transaction
    - (A) consideration per equity security that is not identical in amount and form to the entitlement of the general body of holders in Canada of securities of the same class,
    - (B) a collateral benefit, or
    - (C) consideration for securities of a class of equity securities of the issuer if the issuer has more than one outstanding class of equity securities, unless that consideration is not greater than the entitlement of the general body of holders in Canada of every other class of equity securities of the issuer in relation to the voting and financial participating interests in the issuer represented by the respective securities;

s. 4.1: Application

This Part does not apply to an issuer carrying out a business combination if
(a) the issuer is not a reporting issuer,
(b) the issuer is a mutual fund, or
(c) (i) at the time the business combination is agreed to, securities held by beneficial owners in the local jurisdiction constitute less than two per cent of the outstanding securities of each class of affected securities of the issuer, and
(ii) all documents concerning the transaction that are sent generally to other holders of affected securities of the issuer are concurrently sent to all holders of the securities in the local jurisdiction.

s. 4.2: Meeting and information circular

(1) Without limiting the application of any other legal requirements that apply to meetings of security holders and information circulars, this section applies only to a business combination for which section 4.5 requires the issuer to obtain minority approval.
(2) An issuer proposing to carry out a business combination shall call a meeting of holders of affected securities and send an information circular to those holders.

(3) The issuer shall include in the information circular
(a) the disclosure required by Form 62-104F2 Issuer Bid Circular of Multilateral Instrument 62-104 Take-Over Bids and Issuer Bids, and in Ontario, Form 62-504F2 Issuer Bid Circular of OSC Rule 62-504 Take-Over Bids and Issuer Bids, to the extent applicable and with necessary modifications,
(b) a description of the background to the business combination,
(c) disclosure in accordance with section 6.8 of every prior valuation in respect of the issuer
(i) that has been made in the 24 months before the date of the information circular, and
(ii) the existence of which is known, after reasonable inquiry, to the issuer or to any director or senior officer of the issuer,
(d) disclosure of any bona fide prior offer that relates to the subject matter of or is otherwise relevant to the transaction, which offer was received by the issuer during the 24 months before the business combination was agreed to, and a description of the offer and the background to the offer,
(e) a discussion of the review and approval process adopted by the board of directors and the special committee, if any, of the issuer for the transaction, including a discussion of any materially contrary view or abstention by a director and any material disagreement between the board and the special committee,
(f) disclosure of the formal valuation exemption, if any, on which the issuer is relying under section 4.4 and the facts supporting that reliance,
(g) disclosure of the number of votes attached to the securities that, to the knowledge of the issuer after reasonable inquiry, will be excluded in determining whether minority approval for the business combination is obtained, and
(h) the identity of the holders of securities specified in paragraph (g) together with their individual holdings.
(4) If, after sending the information circular and before the meeting, a change occurs that, if disclosed, would reasonably be expected to affect the decision of a holder of affected securities to vote for or against the business combination or to retain or dispose of affected securities, the issuer shall promptly disseminate disclosure of the change
(a) in a manner that the issuer reasonably determines will inform beneficial owners of affected securities of the change, and
(b) sufficiently in advance of the meeting that the beneficial owners of affected securities will be able to assess the impact of the change.
(5) If subsection (4) applies, the issuer shall file a copy of the disseminated information contemporaneously with its dissemination.

s. 4.3: Formal valuation

(1) An issuer shall obtain a formal valuation for a business combination if
(a) an interested party would, as a consequence of the transaction, directly or indirectly acquire the issuer or the business of the issuer, or combine with the issuer, through an amalgamation, arrangement or otherwise, whether alone or with joint actors, or
(b) an interested party is a party to any connected transaction to the business combination, if the connected transaction is a related party transaction for which the issuer is required to obtain a formal valuation under section 5.4.

(2) If a formal valuation is required under subsection (1), the issuer shall
(a) provide the disclosure required by section 6.2,
(b) include, in accordance with section 6.5, a summary of the formal valuation in the disclosure document for the business combination, unless the formal valuation is included in its entirety in the disclosure document,
(c) state in the disclosure document for the business combination who will pay or has paid for the valuation, and
(d) comply with the other provisions of Part 6 applicable to it relating to formal valuations.

(3) The board of directors of the issuer or an independent committee of the board shall
(a) determine who the valuator will be, and
(b) supervise the preparation of the formal valuation.

s. 4.4: Exemptions from Formal Valuation Requirement

(1)
Section 4.3 does not apply to an issuer carrying out a business combination in any of the following circumstances:
(a)
(b)
Issuer Not Listed on Specified Markets – no securities of the issuer are listed or quoted on the Toronto Stock Exchange, the New York Stock Exchange, the American Stock Exchange, the NASDAQ Stock Market, or a stock exchange outside of Canada and the United States other than the Alternative Investment Market of the London Stock Exchange or the PLUS markets operated by PLUS Markets Group plc,
Previous Arm's Length Negotiations -– all of the following conditions are satisfied:
(i) the consideration per affected security under the business combination is at least equal in value to and is in the same form as the highest consideration agreed to with one or more selling security holders of the issuer in arm's length negotiations in connection with
(A) the business combination,
(B) one or more other transactions agreed to within 12 months before the date of the first public announcement of the business combination, or
(C) a combination of transactions referred to in clauses (A) and (B),
(ii) at least one of the selling security holders party to an agreement referred to in clause (i)(A) or (B) beneficially owns or exercises control or direction over, or beneficially owned or exercised control or direction over, and agreed to sell
(A) at least five per cent of the outstanding securities of the class of affected securities, as determined in accordance with subsection (2), if the person that entered into the agreement with the selling security holder beneficially owned 80 per cent or more of the outstanding securities of the class of affected securities, as determined in accordance with subsection (2), or
(B) at least 10 per cent of the outstanding securities of the class of affected securities, as determined in accordance with subsection (2), if the person that entered into the agreement with the selling security holder beneficially owned less than 80 per cent of the outstanding securities of the class of affected securities, as determined in accordance with subsection (2),
(iii) one or more of the selling security holders party to any of the transactions referred to in subparagraph (i) beneficially owns or exercises control or direction over, or beneficially owned or exercised control or direction over, and agreed to sell, in the aggregate, at least 20 per cent of the outstanding securities of the class of affected securities, as determined in accordance with subsection (3), beneficially owned or over which control or direction was exercised by persons other than the person, and joint actors with the person, that entered into the agreements with the selling security holders,
(iv) the person proposing to carry out the business combination with the issuer reasonably believes, after reasonable inquiry, that at the time of each of the agreements referred to in subparagraph (i)
(A) each selling security holder party to the agreement had full knowledge of and access to information concerning the issuer and its securities, and
(B) any factors peculiar to a selling security holder party to the agreement, including non-financial factors, that were considered relevant by the selling security holder in assessing the consideration did not have the effect of reducing the price that would otherwise have been considered acceptable by that selling security holder,
(v) at the time of each of the agreements referred to in subparagraph (i), the person proposing to carry out the business combination with the issuer did not know of any material information in respect of the issuer or the affected securities that
(A) had not been generally disclosed, and
(B) if disclosed, could have reasonably been expected to increase the agreed consideration,
(vi) any of the agreements referred to in subparagraph (i) was entered into with a selling security holder by a person other than the person proposing to carry out the business combination with the issuer, the person proposing to carry out the business combination with the issuer reasonably believes, after reasonable inquiry,

that at the time of that agreement, the person entering into the agreement with the selling security holder did not know of any material information in respect of the issuer or the affected securities that
(A) had not been generally disclosed, and
(B) if disclosed, could have reasonably been expected to increase the agreed consideration,
(vii) the person proposing to carry out the business combination with the issuer does not know, after reasonable inquiry, of any material information in respect of the issuer or the affected securities since the time of each of the agreements referred to in subparagraph (i) that has not been generally disclosed and could reasonably be expected to increase the value of the affected securities,

(c) Auction – all of the following conditions are satisfied:
(i) the business combination is publicly announced while
(A) one or more proposed transactions are outstanding that
(I) are business combinations in respect of the affected securities, and ascribe a per security value to those securities, or
(II) would be business combinations in respect of the affected securities, except that they come within the exception in paragraph (e) of the definition of business combination, and ascribe a per security value to those securities,
(B) one or more bids for the affected securities have been made and are outstanding,
(ii) at the time the disclosure document for the business combination is sent to the holders of affected securities, the issuer has provided equal access to the issuer, and to information concerning the issuer and its securities, to the person proposing to carry out the business combination with the issuer, all parties to the proposed transactions described in clause (i)(A), and all offerors in the bids,
Second Step Business Combination – all of the following conditions are satisfied:
(i) the business combination is being effected by an offeror that made a bid, or an affiliated entity of that offeror, and is in respect of the securities of the same class for which the bid was made and that were not acquired in the bid,
(ii) the business combination is completed no later than 120 days after the date of expiry of the bid,
(iii) the consideration per security that the security holders would be entitled to receive in the business combination is at least equal in value to and is in the same form as the consideration that the tendering security holders were entitled to receive in the bid,
(iv) the disclosure document for the bid
(A) disclosed that if the offeror acquired securities under the bid, the offeror intended to acquire the remainder of the securities under a statutory right of acquisition or under a business combination that would satisfy the conditions in subparagraphs (ii) and (iii),
(B) described the expected tax consequences of both the bid and the business combination if, at the time the bid was made, the tax consequences arising from the business combination
(I) were reasonably foreseeable to the offeror, and
(II) were reasonably expected to be different from the tax consequences of tendering to the bid, and
(C) disclosed that the tax consequences of the bid and the business combination may be different if, at the time the bid was made, the offeror could not reasonably foresee the tax consequences arising from the business combination,
(e) Non-redeemable Investment Fund – the issuer is a non-redeemable investment fund that
(i) at least once each quarter calculates and publicly disseminates the net asset value of its securities, and
(ii) at the time of publicly announcing the business combination, publicly disseminates the net asset value of its securities as of the business day before the announcement,
(f) Amalgamation or Equivalent Transaction with No Adverse Effect on Issuer or Minority – the transaction is a statutory amalgamation, or substantially equivalent transaction, resulting in the combination of the issuer or a wholly-owned subsidiary entity of the issuer with an interested party, that is undertaken in whole or in part for the benefit of another related party, if all of the following conditions are satisfied:
(i) the transaction does not and will not have any adverse tax or other consequences to the issuer, the person resulting from the combination, or beneficial owners of affected securities generally,

(ii) no material actual or contingent liability of the interested party with which the issuer or a wholly-owned subsidiary entity of the issuer is combining will be assumed by the issuer, the wholly-owned subsidiary entity of the issuer or the person resulting from the combination,
(iii) the related party benefiting from the transaction agrees to indemnify the issuer against any liabilities of the interested party with which the issuer, or a wholly-owned subsidiary entity of the issuer, is combining,
(iv) after the transaction, the nature and extent of the voting and financial participating interests of holders of affected securities in the person resulting from the combination will be the same as, and the value of their financial participating interests will not be less than, that of their interests in the issuer before the transaction,
(v) the related party benefiting from the transaction pays for all of the costs and expenses resulting from the transaction.
(2) For the purposes of subparagraph (b)(ii) of subsection (1), the number of outstanding securities of the class of affected securities
(a) is calculated at the time of the agreement referred to in clause (b)(i)(A) or (B) of subsection (1), if the person proposing to carry out the business combination with the issuer knows the number of securities of the class outstanding at that time; or
(b) if paragraph (a) does not apply, is determined based on the information most recently provided by the issuer in a material change report, or section 5.4 of National Instrument 51-102 Continuous Disclosure Obligations, immediately preceding the date of the agreement referred to in clause (b)(i)(A) or (B) of subsection (1).

(3) For the purposes of subparagraph (b)(iii) of subsection (1), the number of outstanding securities of the class of affected securities
(a) is calculated at the time of the last of the agreements referred to in subparagraph (b)(i) of subsection (1), if the person proposing to carry out the business combination with the issuer knows the number of securities of the class outstanding at that time; or
(b) if paragraph (a) does not apply, is determined based on the information most recently provided by the issuer in a material change report, or section 5.4 of National Instrument 51-102 Continuous Disclosure Obligations, immediately preceding the date of the last of the agreements referred to in subparagraph (b)(i) of subsection (1).

s. 4.5: Minority approval

An issuer shall not carry out a business combination unless the issuer has obtained minority approval for the business combination under Part 8.

s. 4.5: Exemptions from minority approval

(1) Section 4.5 does not apply to an issuer carrying out a business combination in any of the following circumstances if the exemption relied on, any formal valuation exemption relied on, and the facts supporting reliance on those exemptions are disclosed in the disclosure document for the business combination:
(a) 90 Per Cent Exemption – subject to subsection (2), one or more persons that are interested parties within the meaning of subparagraph (c)(i) of the definition of interested party beneficially own, in the aggregate, 90 per cent or more of the outstanding securities of a class of affected securities at the time that the business combination is agreed to, and either
(i) an appraisal remedy is available to holders of the class of affected securities under the statute under which the issuer is organized or is governed as to corporate law matters, or
(ii) if an appraisal remedy referred to in subparagraph (i) is not available, holders of the class of affected securities are given an enforceable right that is substantially equivalent to the appraisal remedy provided for in section 190 of the CBCA and that is described in the disclosure document for the business combination;
(b) Other Transactions Exempt from Formal Valuation – the circumstances described in paragraph (f) of subsection 4.4 (1).
(2) If there are two or more classes of affected securities, paragraph (a) of subsection (1) applies only to a class of which the applicable interested parties beneficially own, in the aggregate, 90 per cent or more of the outstanding securities.

PART 5: Related Party Transactions

s. 1.1: "related party"

"**related party**" of an entity means a person, other than a person that is solely a bona fide lender, that, at the relevant time and after reasonable inquiry, is known by the entity or a director or senior officer of the entity to be

(a) a control person of the entity,
(b) a person of which a person referred to in paragraph (a) is a control person,
(c) a person of which the entity is a control person,
(d) a person that has
  (i) beneficial ownership of, or control or direction over, directly or indirectly, or
  (ii) a combination of beneficial ownership of, and control or direction over, directly or indirectly, securities of the entity carrying more than 10% of the voting rights attached to all the entity's outstanding voting securities,
(e) a director or senior officer of
  (i) the entity, or
  (ii) a person described in any other paragraph of this definition,
(f) a person that manages or directs, to any substantial degree, the affairs or operations of the entity under an agreement, arrangement or understanding between the person and the entity, including the general partner of an entity that is a limited partnership, but excluding a person acting under bankruptcy or insolvency law,
(g) a person of which persons described in any paragraph of this definition beneficially own, in the aggregate, more than 50 per cent of the securities of any outstanding class of equity securities, or
(h) an affiliated entity of any person described in any other paragraph of this definition;

BCSA s. 1.1: "control person"

"**control person**" means

(a) a person who holds a sufficient number of the voting rights attached to all outstanding voting securities of an issuer to affect materially the control of the issuer, or
(b) each person in a combination of persons, acting in concert by virtue of an agreement, arrangement, commitment or understanding, which holds in total a sufficient number of the voting rights attached to all outstanding voting securities of an issuer to affect materially the control of the issuer,

and, if a person or combination of persons holds more than <u>20% of the voting rights</u> attached to all outstanding voting securities of an issuer, the person or combination of persons is deemed, in the absence of evidence to the contrary, to hold a sufficient number of the voting rights to affect materially the control of the issuer;

BCSA s. 1.1: "related party transaction"

"**related party transaction**" means, for an issuer, a transaction between the issuer and a person that is a related party of the issuer at the time the transaction is agreed to, whether or not there are also other parties to the transaction, as a consequence of which, either through the transaction itself or together with connected transactions, the issuer directly or indirectly

(a) purchases or acquires an asset from the related party for valuable consideration,
(b) purchases or acquires, as a joint actor with the related party, an asset from a third party if the proportion of the asset acquired by the issuer is less than the proportion of the consideration paid by the issuer,
(c) sells, transfers or disposes of an asset to the related party,
(d) sells, transfers or disposes of, as a joint actor with the related party, an asset to a third party if the proportion of the consideration received by the issuer is less than the proportion of the asset sold, transferred or disposed of by the issuer,
(e) leases property to or from the related party,

(f) acquires the related party, or combines with the related party, through an amalgamation, arrangement or otherwise, whether alone or with joint actors,
(g) issues a security to the related party or subscribes for a security of the related party,
(h) amends 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 related party, or agrees to the amendment of the terms of a security of the related party if the security is beneficially owned by the issuer or is one over which the issuer exercises control or direction,
(i) assumes or otherwise becomes subject to a liability of the related party,
(j) borrows money from or lends money to the related party, or enters into a credit facility with the related party,
(k) releases, cancels or forgives a debt or liability owed by the related party,
(l) materially amends the terms of an outstanding debt or liability owed by or to the related party, or the terms of an outstanding credit facility with the related party, or
(m) provides a guarantee or collateral security for a debt or liability of the related party, or materially amends the terms of the guarantee or security;

s. 5.1: Application

This Part does not apply to an issuer carrying out a related party transaction if
(a) the issuer is not a reporting issuer,
(b) the issuer is a mutual fund,
(c) (i) at the time the transaction is agreed to, securities held by beneficial owners in the local jurisdiction constitute less than two per cent of the outstanding securities of each class of affected securities of the issuer, and
(ii) all documents concerning the transaction that are sent generally to other holders of affected securities of the issuer are concurrently sent to all holders of the securities in the local jurisdiction,
(d) the parties to the transaction consist solely of
(i) an issuer and one or more of its wholly-owned subsidiary entities, or
(ii) wholly-owned subsidiary entities of the same issuer,
(e) the transaction is a business combination for the issuer,
(f) the transaction would be a business combination for the issuer except that it comes within an exception in any of paragraphs (a) to (e) of the definition of business combination,
(g) the transaction is a downstream transaction for the issuer,
(h) the issuer is obligated to and carries out the transaction substantially under the terms
(i) that were agreed to, and generally disclosed, before December 15, 2000 in Québec and before May 1, 2000 in Ontario,
(ii) that were agreed to, and generally disclosed, before the issuer became a reporting issuer, or
(iii) of a previous transaction the terms of which were generally disclosed, including an issuance of a convertible security, if the previous transaction was carried out in compliance with this Instrument, including in reliance on any applicable exemption or exclusion, or was not subject to this Instrument,
(i) the transaction is a distribution
(i) of securities of the issuer and is a related party transaction for the issuer solely because the interested party is an underwriter of the distribution, and
(ii) carried out in compliance with, including in reliance on any applicable exemption from, National Instrument 33-105 Underwriting Conflicts,
(j)
(k)

s. 5.2: Material change report

(1) An issuer shall include in a material change report, if any, required to be filed under securities legislation for a related party transaction
(a) a description of the transaction and its material terms,
(b) the purpose and business reasons for the transaction,
(c) the anticipated effect of the transaction on the issuer's business and affairs,

(d) a description of
(i) the interest in the transaction of every interested party and of the related parties and associated entities of the interested parties, and
(ii) the anticipated effect of the transaction on the percentage of securities of the issuer, or of an affiliated entity of the issuer, beneficially owned or controlled by each person referred to in subparagraph (i) for which there would be a material change in that percentage,
(e) unless this information will be included in another disclosure document for the transaction, a discussion of the review and approval process adopted by the board of directors and the special committee, if any, of the issuer for the transaction, including a discussion of any materially contrary view or abstention by a director and any material disagreement between the board and the special committee,
(f) a summary, in accordance with section 6.5, of the formal valuation, if any, obtained for the transaction, unless the formal valuation is included in its entirety in the material change report or will be included in its entirety in another disclosure document for the transaction,
(g) disclosure, in accordance with section 6.8, of every prior valuation in respect of the issuer that relates to the subject matter of or is otherwise relevant to the transaction
(i) that has been made in the 24 months before the date of the material change report, and
(ii) the existence of which is known, after reasonable inquiry, to the issuer or to any director or senior officer of the issuer,
(h) the general nature and material terms of any agreement entered into by the issuer, or a related party of the issuer, with an interested party or a joint actor with an interested party, in connection with the transaction, and
(i) disclosure of the formal valuation and minority approval exemptions, if any, on which the issuer is relying under sections 5.5 and 5.7, respectively, and the facts supporting reliance on the exemptions.
(2) If the issuer files a material change report less than 21 days before the expected date of the closing of the transaction, the issuer shall explain in the news release required to be issued under National Instrument 51-102 Continuous Disclosure Obligations and in the material change report why the shorter period is reasonable or necessary in the circumstances.
(3) Despite paragraphs (1)(f) and 5.4(2)(a), if the issuer is required to include a summary of the formal valuation in the material change report and the formal valuation is not available at the time the issuer files the material change report, the issuer shall file a supplementary material change report containing the disclosure required by paragraph (1)(f) as soon as the formal valuation is available.
(4) The issuer shall send a copy of any material change report prepared by it in respect of the transaction to any security holder of the issuer upon request and without charge.

s. 5.3: Meeting and information circular

(1) Without limiting the application of any other legal requirements that apply to meetings of security holders and information circulars, this section applies only to a related party transaction for which section 5.6 requires the issuer to obtain minority approval.
(2) An issuer proposing to carry out a related party transaction to which this section applies shall call a meeting of holders of affected securities and send an information circular to those holders.
(3) The issuer shall include in the information circular
(a) the disclosure required by Form 62-104F2 Issuer Bid Circular of Multilateral Instrument 62-104 Take-Over Bids and Issuer Bids, and in Ontario, Form 62-504F2 Issuer Bid Circular of OSC Rule 62-504 Take-Over Bids and Issuer Bids, to the extent applicable and with necessary modifications,
(b) a description of the background to the transaction,
(c) disclosure, in accordance with section 6.8, of every prior valuation in respect of the issuer that relates to the subject matter of or is otherwise relevant to the transaction
(i) that has been made in the 24 months before the date of the information circular, and
(ii) the existence of which is known, after reasonable inquiry, to the issuer or to any director or senior officer of the issuer,
(d) disclosure of any bona fide prior offer that relates to the subject matter of or is otherwise relevant to the transaction, which offer was received by the issuer during the 24 months before the transaction was agreed to, and a description of the offer and the background to the offer,

(e) a discussion of the review and approval process adopted by the board of directors and the special committee, if any, of the issuer for the transaction, including a discussion of any materially contrary view or abstention by a director and any material disagreement between the board and the special committee,
(f) disclosure of the formal valuation exemption, if any, on which the issuer is relying under section 5.5 and the facts supporting that reliance,
(g) disclosure of the number of votes attached to the securities that, to the knowledge of the issuer after reasonable inquiry, will be excluded in determining whether minority approval for the related party transaction is obtained, and
(h) the identity of the holders of securities specified in paragraph (g) together with their individual holdings.
(4) If, after sending the information circular and before the meeting, a change occurs that, if disclosed, would reasonably be expected to affect the decision of a holder of affected securities to vote for or against the related party transaction or to retain or dispose of affected securities, the issuer shall promptly disseminate disclosure of the change
(a) in a manner that the issuer reasonably determines will inform beneficial owners of affected securities of the change, and
(b) sufficiently in advance of the meeting that the beneficial owners of affected securities will be able to assess the impact of the change.
(5) If subsection (4) applies, the issuer shall file a copy of the disseminated information contemporaneously with its dissemination.

s. 5.4: Formal valuation

(1) An issuer shall obtain a formal valuation for a related party transaction described in any of paragraphs (a) to (g) of the definition of related party transaction.
(2) If a formal valuation is required under subsection (1), the issuer shall
(a) include, in accordance with section 6.5, a summary of the formal valuation in the disclosure document for the related party transaction, unless the formal valuation is included in its entirety in the disclosure document,
(b) state in the disclosure document who will pay or has paid for the valuation, and
(c) comply with the other provisions of Part 6 applicable to it relating to formal valuations.
(3) The board of directors of the issuer or an independent committee of the board shall
(a) determine who the valuator will be, and
(b) supervise the preparation of the formal valuation.

s. 5.4: Exemptions from formal valuation requirement

Section 5.4 does not apply to an issuer carrying out a related party transaction in any of the following circumstances:
(a) Fair Market Value Not More Than 25% of Market Capitalization – at the time the transaction is agreed to, neither the fair market value of the subject matter of, nor the fair market value of the consideration for, the transaction, insofar as it involves interested parties, exceeds 25 per cent of the issuer's market capitalization, and for this purpose
(i) if either of the fair market values is not readily determinable, any determination as to whether that fair market value exceeds the threshold for this exemption shall be made by the issuer's board of directors acting in good faith,
(ii) if the transaction is one in which the issuer or a wholly-owned subsidiary entity of the issuer combines with a related party, through an amalgamation, arrangement or otherwise, the subject matter of the transaction shall be deemed to be the securities of the related party held, at the time the transaction is agreed to, by persons other than the issuer or a wholly- owned subsidiary entity of the issuer, and the consideration for the transaction shall be deemed to be the consideration received by those persons,
(iii) if the transaction is one of two or more connected transactions that are related party transactions and would, without the exemption in this paragraph (a), require formal valuations under this Instrument, the fair market values for all of those transactions shall be aggregated in determining whether the tests for this exemption are met, and

(iv) if the assets involved in the transaction (the "initial transaction") include warrants, options or other instruments providing for the possible future purchase of securities or other assets (the "future transaction"), the calculation of the fair market value for the initial transaction shall include the fair market value, as of the time the initial transaction is agreed to, of the maximum number of securities or other consideration that the issuer may be required to issue or pay in the future transaction,
(b) Issuer Not Listed on Specified Markets – no securities of the issuer are listed or quoted on the Toronto Stock Exchange, the New York Stock Exchange, the American Stock Exchange, the NASDAQ Stock Market, or a stock exchange outside of Canada and the United States other than the Alternative Investment Market of the London Stock Exchange or the PLUS markets operated by PLUS Markets Group plc,
(c) Distribution of Securities for Cash – the transaction is a distribution of securities of the issuer to a related party for cash consideration, if
(i) neither the issuer nor, to the knowledge of the issuer after reasonable inquiry, the related party has knowledge of any material information concerning the issuer or its securities that has not been generally disclosed, and the disclosure document for the transaction includes a statement to that effect, and
(ii) the disclosure document for the transaction includes a description of the effect of the distribution on the direct or indirect voting interest of the related party,
(d) Certain Transactions in the Ordinary Course of Business – the transaction is
(i) a purchase or sale, in the ordinary course of business of the issuer, of inventory consisting of personal or movable property under an agreement that has been approved by the board of directors of the issuer and the existence of which has been generally disclosed, or
(ii) a lease of real or immovable property or personal or movable property under an agreement on reasonable commercial terms that, considered as a whole, are not less advantageous to the issuer than if the lease was with a person dealing at arm's length with the issuer and the existence of which has been generally disclosed,
(e) Transaction Supported by Arm's Length Control Person – the interested party beneficially owns, or exercises control or direction over, voting securities of the issuer that carry fewer voting rights than the voting securities beneficially owned, or over which control or direction is exercised, by another security holder of the issuer who is a control person of the issuer and who, in the circumstances of the transaction
(i) is not also an interested party,
(ii) is at arm's length to the interested party, and
(iii) supports the transaction,
(f) Bankruptcy, Insolvency, Court Order –
(i) the transaction is subject to court approval, or a court orders that the transaction be
effected, under
(A) bankruptcy or insolvency law, or
(B) section 191 of the CBCA, any successor to that section, or equivalent legislation of a jurisdiction,
(ii) the court is advised of the requirements of this Instrument regarding formal valuations for related party transactions, and of the provisions of this paragraph (f), and
(iii) the court does not require compliance with section 5.4,
(g) Financial Hardship –
(i) the issuer is insolvent or in serious financial difficulty,
(ii) the transaction is designed to improve the financial position of the issuer,
(iii) paragraph (f) is not applicable,
(iv) the issuer has one or more independent directors in respect of the transaction, and
(v) the issuer's board of directors, acting in good faith, determines, and at least two-thirds of the issuer's independent directors, acting in good faith, determine that
(A) subparagraphs (i) and (ii) apply, and
(B) the terms of the transaction are reasonable in the circumstances of the issuer,
(h) Asset Resale –
(i) the subject matter of the related party transaction was acquired by the issuer or an interested party, as the case may be, in a prior arm's length transaction that was agreed to not more than 12 months before the date that the related party transaction is agreed to, and a qualified, independent valuator provides a written opinion that, after making such adjustments, if any, as the valuator considers appropriate in the exercise of the valuator's professional judgment

(A) the value of the consideration payable by the issuer for the subject matter of the related party transaction is not more than the value of the consideration paid by the interested party in the prior arm's length transaction, or
(B) the value of the consideration to be received by the issuer for the subject matter of the related party transaction is not less than the value of the consideration paid by the issuer in the prior arm's length transaction, and
(ii) the disclosure document for the related party transaction includes the same disclosure regarding the valuator as is required in the case of a formal valuation under section 6.2,
(i) Non-redeemable Investment Fund – the issuer is a non-redeemable investment fund that
(i) at least once each quarter calculates and publicly disseminates the net asset value of its securities, and
(ii) at the time of publicly announcing the related party transaction, publicly disseminates the net asset value of its securities as of the business day before the announcement,
(j) Amalgamation or Equivalent Transaction with No Adverse Effect on Issuer or Minority – the transaction is a statutory amalgamation, or substantially equivalent transaction, resulting in the combination of the issuer or a wholly-owned subsidiary entity of the issuer with an interested party, that is undertaken in whole or in part for the benefit of another related party, if all of the following conditions are satisfied:
(i) the transaction does not and will not have any adverse tax or other consequences to the issuer, the person resulting from the combination, or beneficial owners of affected securities generally,
(ii) no material actual or contingent liability of the interested party with which the issuer or a wholly-owned subsidiary entity of the issuer is combining will be assumed by the issuer, the wholly-owned subsidiary entity of the issuer or the person resulting from the combination,
(iii) the related party benefiting from the transaction agrees to indemnify the issuer against any liabilities of the interested party with which the issuer, or a wholly-owned subsidiary entity of the issuer, is combining,
(iv) after the transaction, the nature and extent of the voting and financial participating interests of holders of affected securities in the person resulting from the combination will be the same as, and the value of their financial participating interests will not be less than, that of their interests in the issuer before the transaction,
(v) the related party benefiting from the transaction pays for all of the costs and expenses resulting from the transaction.

s. 5.4: Minority approval

An issuer shall not carry out a related party transaction unless the issuer has obtained minority approval for the transaction under Part 8.

s. 5.4: Exemptions from minority approval requirement

(1) Subject to subsections (2), (3), (4) and (5), section 5.6 does not apply to an issuer carrying out a related party transaction in any of the following circumstances if the exemption relied on, any formal valuation exemption relied on, and the facts supporting reliance on those exemptions are disclosed in the disclosure document, if any, for the transaction:
(a) Fair Market Value Not More Than 25 Per Cent of Market Capitalization – the circumstances described in paragraph (a) of section 5.5,
(b) Fair Market Value Not More Than $2,500,000 – Distribution of Securities for Cash – the circumstances described in paragraph (c) of section 5.5, if
(i)no securities of the issuer are listed or quoted on the Toronto Stock Exchange, the New York Stock Exchange, the American Stock Exchange, the NASDAQ Stock Market, or a stock exchange outside of Canada and the United States other than the Alternative Investment Market of the London Stock Exchange or the PLUS markets operated by PLUS Markets Group plc,
(ii) at the time the transaction is agreed to, neither the fair market value of the securities to be distributed in the transaction nor the consideration to be received for those securities, insofar as the transaction involves interested parties, exceeds $2,500,000,
(iii) the issuer has one or more independent directors in respect of the transaction who are not employees of the issuer, and

(iv) at least two-thirds of the directors described in subparagraph (iii) approve the transaction,
(c) Other Transactions Exempt from Formal Valuation – the circumstances described in paragraphs (d), (e) and (j) of section 5.5,
(d) Bankruptcy, Insolvency, Court Order – the circumstances described in subparagraph (f)(i) of section 5.5, if the court is advised of the requirements of this Instrument regarding minority approval for related party transactions, and of the provisions of this paragraph, and the court does not require compliance with section 5.6,
(e) Financial Hardship – the circumstances described in paragraph (g) of section 5.5, if there is no other requirement, corporate or otherwise, to hold a meeting to obtain any approval of the holders of any class of affected securities,
(f) Loan to Issuer, No Equity or Voting Component –
(i) the transaction is a loan, or the creation of a credit facility, that is obtained by the issuer from a related party on reasonable commercial terms that are not less advantageous to the issuer than if the loan or credit facility were obtained from a person dealing at arm's length with the issuer, and the loan, or each advance under the credit facility, as the case may be, is not
(A) convertible, directly or indirectly, into equity or voting securities of the issuer or a subsidiary entity of the issuer, or otherwise participating in nature, or
(B) repayable as to principal or interest, directly or indirectly, in equity or voting securities of the issuer or a subsidiary entity of the issuer,
(ii) and for this purpose, any amendment to the terms of a loan or credit facility is deemed to create a new loan or credit facility,
(g) 90 Per Cent Exemption – one or more persons that are interested parties within the meaning of subparagraph (d)(i) of the definition of interested party beneficially own, in the aggregate, 90 per cent or more of the outstanding securities of a class of affected securities at the time the transaction is agreed to, and either
(i) an appraisal remedy is available to holders of the class of affected securities under the statute under which the issuer is organized or is governed as to corporate law matters, or
(ii) if an appraisal remedy referred to in subparagraph (i) is not available, holders of the class of affected securities are given an enforceable right that is substantially equivalent to the appraisal remedy provided for in section 190 of the CBCA and that is described in an information circular or other document sent to holders of that class of affected securities in connection with a meeting to approve the related party transaction, or, if there is no such meeting, in another document that is sent to those security holders not later than the time by which an information circular or other document would have been required to be sent to them if there had been a meeting.
(2) Despite subparagraph (a)(iii) of section 5.5, if the transaction is one of two or more connected transactions that are related party transactions and would, without the exemptions in paragraphs (a) and (b) of subsection (1), require minority approval under this Instrument, the fair market values for all of those transactions shall be aggregated in determining whether the tests for those exemptions are met.
(3) If the transaction is a material amendment to the terms of a security, or of a loan or credit facility to which the exemption in paragraph (f) of subsection (1) does not apply, the fair market value tests for the exemptions in paragraphs (a) and (b) of subsection (1) shall be applied to the whole transaction as amended, insofar as it involves interested parties, rather than just to the amendment, and, for this purpose, any addition of, or amendment to, a term involving a right to convert into or otherwise acquire equity or voting securities is deemed to be a material amendment.
(4) Subparagraphs (a)(i), (iii) and (iv) of section 5.5 apply to paragraph (b) of subsection 5.7(1) with appropriate modifications.
(5) If there are two or more classes of affected securities, paragraph (g) of subsection (1) applies only to a class of which the applicable interested parties beneficially own, in the aggregate, 90 per cent or more of the outstanding securities.

PART 6: Formal Valuation and Prior Valuations

s. 6.1: Independence and qualifications of valuator

(1) Every formal valuation required by this Instrument for a transaction shall be prepared by a valuator that is independent of all interested parties in the transaction and that has appropriate qualifications.
(2) It is a question of fact as to whether a valuator is independent of an interested party or has appropriate qualifications.
(3) A valuator is not independent of an interested party in connection with a transaction if
(a) the valuator is an associated or affiliated entity or issuer insider of the interested party,
(b) except in the circumstances described in paragraph (e), the valuator acts as an adviser to the interested party in respect of the transaction, but for this purpose, a valuator that is retained by an issuer to prepare a formal valuation for an issuer bid is not, for that reason alone, considered to be an adviser to the interested party in respect of the transaction,
(c) the compensation of the valuator depends in whole or in part on an agreement, arrangement or understanding that gives the valuator a financial incentive in respect of the conclusion reached in the formal valuation or the outcome of the transaction,
(d) the valuator is
(i) a manager or co-manager of a soliciting dealer group for the transaction, or
(ii) a member of a soliciting dealer group for the transaction, if the valuator, in its capacity as a soliciting dealer, performs services beyond the customary soliciting dealer's function or receives more than the per security or per security holder fees payable to other members of the group,
(e) the valuator is the external auditor of the issuer or of an interested party, unless the valuator will not be the external auditor of the issuer or of an interested party upon completion of the transaction and that fact is publicly disclosed at the time of or prior to the public disclosure of the results of the valuation, or
(f) the valuator has a material financial interest in the completion of the transaction,
and for the purposes of this subsection, references to the valuator include any affiliated entity of the valuator.
(4) A valuator that is paid by one or more interested parties in a transaction, or paid jointly by the issuer and one or more interested parties in a transaction, to prepare a formal valuation for the transaction is not, by virtue of that fact alone, not independent.

s. 6.2: Disclosure regarding valuator

An issuer or offeror required to obtain a formal valuation for a transaction shall include in the disclosure document for the transaction
(a) a statement that the valuator has been determined to be qualified and independent,
(b) a description of any past, present or anticipated relationship between the valuator and the issuer or an interested party that may be relevant to a perception of lack of independence,
(c) a description of the compensation paid or to be paid to the valuator,
(d) a description of any other factors relevant to a perceived lack of independence of the valuator,
(e) the basis for determining that the valuator is qualified, and
(f) the basis for determining that the valuator is independent, despite any perceived lack of independence, having regard to the amount of the compensation and any factors referred to in paragraphs (b) and (d).

s. 6.3: Subject matter of formal valuation

(1) An issuer or offeror required to obtain a formal valuation shall provide the valuation in respect of
(a) the offeree securities, in the case of an insider bid or issuer bid,
(b) the affected securities, in the case of a business combination,
(c) any non-cash consideration being offered to, or to be received by, the holders of securities referred to in paragraph (a) or (b), and
(d) the non-cash assets involved in a related party transaction.
(2) A formal valuation of non-cash consideration or assets referred to in paragraph (1)(c) or (d) is not required if
(a) the non-cash consideration or assets are securities of a reporting issuer or are securities of a class for which there is a published market,
(b) the person that would otherwise be required to obtain the formal valuation of those securities states in the disclosure document for the transaction that the person has no knowledge of any material information concerning the issuer of the securities, or concerning the securities, that has not been generally disclosed,

(c) in the case of an insider bid, issuer bid or business combination
(i) a liquid market in the class of securities exists,
(ii) the securities constitute 25 per cent or less of the number of securities of the class that are outstanding immediately before the transaction,
(iii) the securities are freely tradeable at the time the transaction is completed, and
(iv) the valuator is of the opinion that a valuation of the securities is not required, and
(d) in the case of a related party transaction for the issuer of the securities, the conditions in subparagraphs (c)(i) and (ii) of section 5.5 are satisfied, regardless of the form of the consideration for the securities.

s. 6.4: Preparation of formal valuation

(1) A formal valuation shall contain the valuator's opinion as to a value or range of values representing the fair market value of the subject matter of the valuation.
(2) A person preparing a formal valuation under this Instrument shall
(a) prepare the formal valuation in a diligent and professional manner,
(b) prepare the formal valuation as of an effective date that is not more than 120 days before the earlier of
(i) the date that the disclosure document for the transaction is first sent to security holders, if applicable, and
(ii) the date that the disclosure document is filed,
(c) make appropriate adjustments in the formal valuation for material intervening events of which it is aware between the effective date of the valuation and the earlier of the dates referred to in subparagraphs (i) and (ii) of paragraph (b),
(d) in determining the fair market value of offeree securities or affected securities, not include in the formal valuation a downward adjustment to reflect the liquidity of the securities, the effect of the transaction on the securities or the fact that the securities do not form part of a controlling interest, and
(e) provide sufficient disclosure in the formal valuation to allow the readers to understand the principal judgments and principal underlying reasoning of the valuator so as to form a reasoned judgment of the valuation opinion or conclusion.

s. 6.5: Summary of formal valuation

(1) An issuer or offeror required to provide a summary of a formal valuation shall ensure that the summary provides sufficient detail to allow the readers to understand the principal judgments and principal underlying reasoning of the valuator so as to form a reasoned judgment of the valuation opinion or conclusion.
(2) In addition to the disclosure referred to in subsection (1), if an issuer or offeror is required to provide a summary of a formal valuation, the issuer or offeror shall ensure that the summary
(a) discloses
(i) the effective date of the valuation, and
(ii) any distinctive material benefit that might accrue to an interested party as a consequence of the transaction, including the earlier use of available tax losses, lower income taxes, reduced costs or increased revenues,
(b) if the formal valuation differs materially from a prior valuation, explains the differences between the two valuations or, if it is not practicable to do so, the reasons why it is not practicable to do so,
(c) indicates an address where a copy of the formal valuation is available for inspection, and
(d) states that a copy of the formal valuation will be sent to any security holder upon request and without charge or, if the issuer or offeror providing the summary so chooses, for a nominal charge sufficient to cover printing and postage.

s. 6.8: Disclosure of prior valuations

(1) A person required to disclose a prior valuation shall, in the document in which the prior valuation is required to be disclosed
(a) disclose sufficient detail to allow the readers to understand the prior valuation and its relevance to the present transaction,
(b) indicate an address where a copy of the prior valuation is available for inspection, and

(c) state that a copy of the prior valuation will be sent to any security holder upon request and without charge or, if the issuer or offeror providing the summary so chooses, for a nominal charge sufficient to cover printing and postage.
(2) If there are no prior valuations, the existence of which is known after reasonable inquiry, the person that would be required to disclose prior valuations, if any existed, shall include a statement to that effect in the document.
(3) Despite anything to the contrary in this Instrument, disclosure of the contents of a prior valuation is not required in a document if
(a) the contents are not known to the person required to disclose the prior valuation,
(b) the prior valuation is not reasonably obtainable by the person required to disclose it, irrespective of any obligations of confidentiality, and
(c) the document contains statements regarding the prior valuation substantially to the effect of paragraphs (a) and (b).

PART 7: Independent Directors

s. 7.1: Independent directors

(1) For the purposes of this Instrument, it is a question of fact as to whether a director of an issuer is independent.
A director of an issuer is not independent in connection with a transaction if the director
(a) is an interested party in the transaction,
(b) is currently, or has been at any time during the 12 months before the date the transaction is agreed to, an employee, associated entity or issuer insider of an interested party, or of an affiliated entity of an interested party, other than solely in his or her capacity as a director of the issuer,
(c) is currently, or has been at any time during the 12 months before the date the transaction is agreed to, an adviser to an interested party in connection with the transaction, or an employee, associated entity or issuer insider of an adviser to an interested party in connection with the transaction, or of an affiliated entity of such an adviser, other than solely in his or her capacity as a director of the issuer,
(d) has a material financial interest in an interested party or an affiliated entity of an interested party, or
(e) would reasonably be expected to receive a benefit as a consequence of the transaction that is not also available on a pro rata basis to the general body of holders in Canada of offeree securities or affected securities, including, without limitation, the opportunity to obtain a financial interest in an interested party, an affiliated entity of an interested party, the issuer or a successor to the business of the issuer.
(3) A member of an independent committee for a transaction to which this Instrument applies shall not receive any payment or other benefit from an issuer, an interested party or a successor to any of them that is contingent upon the completion of the transaction.
(4) For the purposes of this section, in the case of an issuer bid, a director of the issuer is not, by that fact alone, not independent of the issuer.

PART 8: Minority Approval

s. 8.1: General

(1) If minority approval is required for a business combination or related party transaction, it shall be obtained from the holders of every class of affected securities of the issuer, in each case voting separately as a class.
(2) In determining minority approval for a business combination or related party transaction, an issuer shall exclude the votes attached to affected securities that, to the knowledge of the issuer or any interested party or their respective directors or senior officers, after reasonable inquiry, are beneficially owned or over which control or direction is exercised by
(a) the issuer,
(b) an interested party,
(c) a related party of an interested party, unless the related party meets that description solely in its capacity as a director or senior officer of one or more persons that are neither interested parties nor issuer insiders of the issuer, or

(d) a joint actor with a person referred to in paragraph (b) or (c) in respect of the transaction.

s. 8.2: Second Step Business Combination

Despite subsection 8.1(2), the votes attached to securities acquired under a bid may be included as votes in favour of a subsequent business combination in determining whether minority approval has been obtained if
(a) the security holder that tendered the securities to the bid was not a joint actor with the offeror in respect of the bid,
(b) the security holder that tendered the securities to the bid was not
(i) a direct or indirect party to any connected transaction to the bid, or
(ii) entitled to receive, directly or indirectly, in connection with the bid
(A) consideration per offeree security that was not identical in amount and form to the entitlement of the general body of holders in Canada of securities of the same class,
(B) a collateral benefit, or
(C) consideration for securities of a class of equity securities of the issuer if the issuer had more than one outstanding class of equity securities, unless that consideration was not greater than the entitlement of the general body of holders in Canada of every other class of equity securities of the issuer in relation to the voting and financial participating interests in the issuer represented by the respective securities,
(c) the business combination is being effected by the offeror that made the bid, or an affiliated entity of that offeror, and is in respect of the securities of the same class for which the bid was made and that were not acquired in the bid,
(d) the business combination is completed no later than 120 days after the date of expiry of the bid,
(e) the consideration per security that the holders of affected securities would be entitled to receive in the business combination is at least equal in value to and is in the same form as the consideration that the tendering security holders were entitled to receive in the bid, and
(f) the disclosure document for the bid
(i) disclosed that if the offeror acquired securities under the bid, the offeror intended to acquire the remainder of the securities under a statutory right of acquisition or under a business combination that would satisfy the conditions in paragraphs (d) and (e),
(ii) contained a summary of a formal valuation of the securities in accordance with the applicable provisions of Part 6, or contained the valuation in its entirety, if the offeror in the bid was subject to and not exempt from the requirement to obtain a formal valuation,
(iii) stated that the business combination would be subject to minority approval,
(iv) disclosed the number of votes attached to the securities that, to the knowledge of the issuer after reasonable inquiry, would be required to be excluded in determining whether minority approval for the business combination had been obtained,
(v) identified the holders of securities specified in subparagraph (iv) and set out their individual holdings,
(vi) identified each class of securities the holders of which would be entitled to vote separately as a class on the business combination,
(vii) described the expected tax consequences of both the bid and the business combination if, at the time the bid was made, the tax consequences arising from the business combination
(A) were reasonably foreseeable to the offeror, and
(B) were reasonably expected to be different from the tax consequences of tendering to the bid, and
(viii) disclosed that the tax consequences of the bid and the business combination may be different if, at the time the bid was made, the offeror could not reasonably foresee the tax consequences arising from the business combination.

PART 9: Exemption

(1) In Québec, 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. This exemption is granted under section 263 of the Securities Act (R.S.Q., C. V-1).
(2) In Ontario, 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.