**SUBMISSION OF THE TAKE-OVER BID TEAM
AT THE ONTARIO SECURITIES COMMISSION
IN CONNECTION WITH THE
FIVE-YEAR REVIEW OF
SECURITIES LEGISLATION IN ONTARIO**

August 11, 2000

## TABLE OF CONTENTS


Overview and Executive Summary . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 1

Legislative Amendment Recommended . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 2

Further Study Required Before any Legislative Amendment is Undertaken . . . . . . . . . . . 2

Further Study Required But Legislative Amendment Unnecessary as Adequate Rule-Making Authority Exists . . . . . . . . . . . . . . . . . . . . . . . . 3

Legislative Authority . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 5

Those Issues For Which the Team Recommends Legislative Amendment . . . . . . . . . . . . . . . . . 6

Third-Party Offers for Less Than 20% of a Class (Mini-Tenders) . . . . . . . . . . . . . . . . . 6

Convertible Securities . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 7

Further Study Required Before any Legislative Amendment is Undertaken . . . . . . . . . . . . . . . . 8

Form of Transaction . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 8

Remedies Generally . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 9

Further Study Required But Legislative Amendment Unnecessary as Adequate Rule-Making Authority Exists . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 11

*De Minimis* Exemption . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 11

Financing . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 12

Bid Conditions . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 14

Defensive Tactics . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 15

Regulated Communications . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 16

Delivery of Communications . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 18

Early Warning . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 19

Meaning of “acquisition” and “acquire” in Part XX . . . . . . . . . . . . . . . . . . . . . . . . . 20

Disclosure of Change of Control Provisions . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 20

Refining Disclosure Requirements . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 22

Tendering Mechanics . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 23

Remedies - Return of Securities . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 24

Pre-bid Integration . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 24

Availability of “Normal Course” Take-over Bid Exemptions . . . . . . . . . . . . . . . . . . . 25

Availability of “Private Agreement Exemption” . . . . . . . . . . . . . . . . . . . . . . . . . . . . 26

Other Issues - Codifying Certain Routinely-Granted Exemptions . . . . . . . . . . . . . . . . 27

Business Day . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 28

Proxy Reform . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 29

Conclusion . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 29

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Dear Mr. Crawford:

**Re: Five-Year Review of Securities Legislation in Ontario**

## OVERVIEW AND EXECUTIVE SUMMARY

This submission is being presented to the Securities Review Advisory Committee (the "Committee") by staff of the take-over bid team (the "Team") at the Ontario Securities Commission ("OSC") in response to the Committee's request for comments published April 28, 2000 (the "Notice").[1]

The OSC established the Team in January 1999 as a specialized transactional and policy team within the Corporate Finance Branch to assist in the regulation of take-over/issuer bids, going private transactions and related party transactions (collectively, "M&A Transactions"). Accordingly, this submission is largely confined to these topics.

Since its establishment, the Team has been involved in and reviewed numerous M&A Transactions, reflecting the significant volume of M&A activity in Ontario's capital markets and the increased sophistication of M&A practice. The Team has also given a fair bit of thought to policy considerations in the area.

Seventeen years have passed since the last comprehensive review of the provisions of the *Securities Act* (Ontario) (the "Act")[2] relating to take-over bids and issuer bids.[3] Although the legislation in this area generally has served Ontario capital markets well, the Team has identified a number of issues

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[1]The views expressed in this submission do not necessarily represent the views of the OSC or other staff of the OSC.

[2]R.S.O. 1990, c.S.5 (as amended).

[3]See Gordon Coleman *et al., Report of the Committee to Review the Provisions of the Securities Act (Ontario) Relating to Take-over Bids and Issuer Bids* (September 1983) (the "Practitioners' Report"); and Securities Industry Committee on Take-over Bids, *The Regulation of Take-over Bids in Canada: Premium Private Agreement Transactions* (November 1983).

that merit further consideration. This submission is responsive to several issues raised in the Notice.[4] It also raises others. The purpose of this submission is to identify these issues for the Committee and recommend a path forward for their resolution.

In this submission, the issues are categorized as follows:[5]

(i) issues where the Team recommends legislative amendment;
(ii) issues where legislative amendment would be required but which the Team believes require further study before any such amendment is undertaken; and
(iii) issues for which there is adequate rule-making authority but that require further study and analysis before any rules are made.

***Legislative Amendment Recommended***

The Team recommends that the Act be amended as follows:

- Clause 143(1)(28) of the Act should be amended to permit the OSC to vary the definition of "take-over bid" under the Act in order to permit the OSC to make rules in respect of offers to acquire less than 20% of the outstanding securities of a class. The purpose of this amendment would be to enable the OSC to make rules regulating mini-tenders and other broadly disseminated offers to acquire less than 20% of a class of securities, which is the current threshold for take-over bid regulation under the Act.

- Clause 143(1)(28) of the Act should be amended to permit the OSC to make rules in respect of offers to acquire securities that are convertible into voting or equity securities. The current application of Part XX of the Act to such securities could be clearer.

***Further Study Required Before any Legislative Amendment is Undertaken***

- The Commentary to the Notice noted that the Commission des valeurs mobilières du Québec (the "CVMQ") has issued a notice stating that it will be asking the Canadian Securities Administrators Take-over Bid Committee (the "CSA Take-over Bid Committee") to consider whether the take-over bid provisions should be extended to transactions that are not structured as take-over bids but that achieve the same result, such as arrangements. The

[4] Most notably II.29 (takeover bids), but also I.2 (core principle/rule approach), II.18 (nominee shareholders), .19 (continuous disclosure), .28 (shareholder communications), .30 (insider trading) and .31 (fraud and market manipulation), III.32 (inter-provincial cooperation) and .33 (globalization), IV.34 (impact of technology generally), .35 (using the Internet to communicate with stakeholders) and .37 (modifying mode of delivery of documents), and V.39 (rule-making authority), .40 (enforcement powers), .41 (mandate of the OSC) and .42 (guiding principles).

[5] The categories have been selected based on a "least disturbance" approach to the current legislation. Further amendment to the legislation would be required if the "broad principle/detailed rule approach" identified in item I.2 of the Notice were adopted.

Team believes that this subject requires thoughtful and thorough analysis before any legislative amendment is undertaken.

- The adequacy of the powers and remedies available to the OSC, generally, to regulate M&A Transactions is a subject that requires further thoughtful analysis before legislative amendment is undertaken.

***Further Study Required But Legislative Amendment Unnecessary as Adequate Rule-Making Authority Exists***

There are a number of other issues concerning M&A Transaction regulation that the Team believes require further consideration. To the extent that the study of these issues results in the need for regulatory reform, the Team believes that such reform could be effected through the implementation of rules for which adequate rule-making authority currently exists.

These issues include the following:

- Should the *de minimis* thresholds in the Act exempting foreign bids from the application of the Act be increased, and if so, to what level?

- Is there a need to clarify what constitutes adequate financing arrangements prior to the commencement of a bid, and if so, how should this requirement be clarified?

- Is there a need to regulate the types of conditions to which a bid may be subject?

- Is the OSC's policy on defensive tactics, including its approach to shareholder rights plans (or poison pills), appropriate, and if not, what changes should be made?

- Is additional regulation necessary in respect of communications made in the context of M&A Transactions, and if so, what form should that regulation take?

- Are the time frames and methods for delivery of disclosure documents in the context of M&A Transactions appropriate, and if not, what changes should be made?

- Do the provisions relating to a prospective bidder's accumulation of a target company's shares prior to public announcement of the transaction require revision, and if so, what form should that revision take?

- Does the application of Part XX of the Act to the acquisition of securities from treasury in certain circumstances require clarification?

- Is additional public disclosure necessary in respect of agreements or arrangements that affect control of an issuer or contain provisions that have material consequences in the event of a change of control?

- Is greater precision desirable in respect of the disclosure required in M&A Transactions where shares are being issued?

- Are the tendering procedures currently provided for in the Act adequate, and if not, how could they be improved?

- Should a rule be made expressly requiring an offeror, at its own expense, to return securities that it has not paid for within the prescribed time period?

- Should the pre-bid integration provisions of the Act be clarified, particularly where share consideration is being issued in the subsequent take-over bid?

- Does the normal course purchase exemption from the take-over bid requirements require further clarification?

- Is further clarification required in connection with the private agreement exemption?

- Should certain refinements be made in the area of issuer bid regulation, including the codification of relief that is regularly granted in connection with "Dutch Auction" issuer bids?

- Should certain other regulatory relief that is routinely granted be codified?

- Does the term "business day", as it is used in Part XX of the Act, require clarification?

The Team recognizes that this submission raises a number of issues that may be beyond the scope of the Committee's agenda. The issues are raised, nevertheless, for the Committee to consider as it sees fit. A path forward for the Committee might be to focus on those two issues for which the Team is recommending legislative amendment while leaving the other issues for separate study and analysis. The Team believes that such separate study and analysis ultimately should be undertaken to ensure that Ontario's regulation of M&A Transactions meets only one standard - the standard of excellence.

The Team notes that a number of the issues raised in the Notice[6] deal with the globalization theme and in the Team's view, appropriately so. If Ontario is to gain its fair share of invested global capital it must have securities regulation that is, and is perceived to be, investor-friendly on a global

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[6]See items III.32, III.33 and V.41.

comparative basis. In order to attract and retain issuers, such regulation also must be as issuer-friendly as possible. Although balancing these sometimes conflicting objectives can be difficult, it is imperative that such a balance be achieved as part of the five-year review process and on an ongoing basis.

Furthermore, although the Canadian capital markets are relatively sophisticated, they also are relatively small. From a global perspective, issuers and investors will ignore the Canadian capital markets if the cost of compliance with securities regulation outweighs the benefits. The Team recognizes this and works closely with its colleagues in other CSA jurisdictions to ensure that the securities regulation of M&A Transactions in Canada is as seamless as possible. To the extent Ontario reform is undertaken in the regulation of M&A Transactions, it will be necessary to seek to have such changes made nationally.

**LEGISLATIVE AUTHORITY**

The legislation, regulations, rules and policies governing M&A Transactions are set out primarily in:

- Part XX (sections 89-105) of the Act dealing with take-over bids, issuer bids and the early warning system;

- Part X (sections 183-203.2) of the *Securities Act General Regulation,* R.R.O. 1990, Reg. 1015, as amended (the "Associated Regulations");

- Rule 61-501 and Companion Policy 61-501CP dealing with insider bids, issuer bids, going private transactions and related party transactions; and

- National Policy 62-202 dealing with defensive tactics in take-over bids.[7]

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[7]Other instruments include: National Policy 62-201 (Bids Made Only in Certain Jurisdictions); Recognition Order 62-904 (Recognition of Certain Jurisdictions); OSC Policy 7.4 (Business and Asset Combinations); OSC Policy 9.3 (Take-over Bids - Miscellaneous Guidelines); National Instrument 62-103 (Early Warning System and Related Take-over Bid and Insider Reporting Issues); CSA Staff Notice 61-301 (Mini-tenders); Recognition Order 21-901 (Stock Exchange Recognition Order); Rule 45-501 (Exempt Distributions); Rule 71-101 (Multijurisdictional Disclosure System); Rule 71-801 (Implementing the Multijurisdictional Disclosure System); OSC Notice 31 (Publication of Early Warning Information); and Proposed Rule 62-501 (Prohibited Transactions in Connection with Take-over Bids).

See also the following forms prescribed under the Act: Form 31 (Notice of Intention to Make an Issuer Bid); Form 32 (Take-Over Bid Circular); Form 33 (Issuer Bid Circular); Form 34 (Directors' Circular); Form 35 (Director's or Officer's Circular); Form 42 (Report of Take-over Bid, Issuer Bid or Application under Clause 104(2)(c) of the Act); Form 43 (Report of Notice of Variation of Take-Over Bid or Issuer Bid); and Form 44 (Report of Going Private Transaction).

Rule-making authority in connection with M&A Transactions is set out principally in clause 143(1)(28) of the Act and will be expanded upon proclamation of certain sections (collectively, the "Expanded Rule-Making Authority") of the *More Tax Cuts for Jobs, Growth and Prosperity Act, 1999* (the "1999 Act").[8]

This submission seeks legislative amendment only where necessary. To the extent current rule-making authority is sufficient or further study of an issue is necessary prior to recommending legislative amendment, legislative amendment is not being sought.

The Team would support a Part XX of the Act that contained a few core principles, with the balance being set out in rules, provided it is determined that this would be a positive change from a cost/benefit analysis perspective. Part XX has been largely unchanged since 1987 and has become well-understood over time by practitioners and the OSC. Accordingly it should be demonstrably evident that a "core principle/rule" approach is superior to a "least disturbance" approach before the former approach is taken.[9]

## THOSE ISSUES FOR WHICH THE TEAM RECOMMENDS LEGISLATIVE AMENDMENT

The Team recommends legislative amendment in respect of the following matters:

### *Third-Party Offers for Less Than 20% of a Class (Mini-Tenders)*

Currently, Part XX of the Act regulates take-over bids where the bid would result in the offeror beneficially owning at least 20% of the target's voting or equity securities. The Team is not recommending that this threshold generally be altered but recommends that clause 143(1)(28) of the Act be amended to permit the OSC to make rules respecting broadly disseminated third party offers for less than 20% of a target's shares.

The stimulus for this recommendation is the recent flurry of "mini-tenders". Mini-tenders are offers made for well under 20% of a target's shares, typically at a discount to the market price of such

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[8]S.O.1999, c.9, subsections 220(3), (4), (5) and (6) (reproduced at (1999) 22 OSCB 8395 at 8408-8409). The 1999 Act also includes provisions (the "Zimmerman Amendments") that, upon proclamation, will implement the recommendations of the *Report of the Committee to Review Take-over Bid Time Limits* (May 1996) (the "Zimmerman Report"), reproduced at (1996) 19 OSCB 4469.

[9]The foregoing discussion is responsive in part to items I.2 and V.39 of the Notice. This is not only a provincial issue. The CSA strive for uniform securities regulation of M&A Transactions across the country. To the extent other provincial jurisdictions get rule-making authority and regulate M&A Transactions by rule versus legislation, the easier it should be to achieve timely uniform regulation in this area. For example, nearly four years have elapsed since the Zimmerman Committee delivered its report and made its recommendations. One major provincial jurisdiction has still been unable to have legislation passed to incorporate the Zimmerman Committee's recommendations.

shares. Staff of the CSA has issued a notice advising of staff's concerns with respect to such practice and recommending enhanced disclosure.[10]

Since the Mini-Tender Notice was released, mini-tenders have continued to flourish and a novel share exchange mini-tender was temporarily cease-traded by the OSC and subsequently withdrawn by the offeror in light of staff's concerns.[11] Staff believes that broadly disseminated offers for less than 20% of a target's shares should be subject to certain minimal regulation and recommends that this matter be further pursued. Such regulation by way of rule would include the application of certain disclosure and procedural requirements to such offers, including the likely application of certain provisions contained in Part XX of the Act. It should be noted that, in the United States, the Securities Exchange Act of 1934 (the "Exchange Act") provides for scaled-down regulation of offers for less than 5% of a target's outstanding shares[12] and the Securities and Exchange Commission (the "SEC") recently has cracked down on mini-tenders.[13]

***Convertible Securities***

The application of formal take-over bid rules to convertible securities could be made clearer under the Act.[14] Section 92 of the Act contains an anti-avoidance rule, which provides that:

> "a reference to an offer to acquire or to the acquisition or ownership of securities or to control or direction over securities shall be construed to include a direct or indirect offer to acquire or the direct or indirect acquisition or ownership of securities, or the direct or indirect control or direction over securities, as the case may be."

When does the purchase of convertible securities constitute the purchase of the underlying shares versus the purchase of the debenture? The answer to this question has obvious ramifications in the context of identical consideration rules, among other provisions.

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[10]CSA Staff Notice 61-301: Staff Guidance on the Practice of "Mini-Tenders" (1999) 22 OSCB 7797 (the "Mini-Tender Notice").

[11]*Re Otis-Winston Ltd., Xillix Technologies Corp., and Digital Cybernet Corporation* (2000) 23 OSCB 3967 (Notice of Hearing and Statement of Allegations of OSC Staff) and 4027 (Temporary Order).

[12]Such offers are subject to a general anti-fraud rule as well as timing and prompt payment rules.

[13]SEC Interpretation: *Staff Guidance on Mini-Tender Offers and Limited Partnership Tender Offers*, 17 CFR Parts 241 and 247); Release No. 34-43069; IC-24564.

[14]For a recent discussion of the problem see W.M. Ainley, "Legal Developments in Canadian M&A Practice", in *Mergers, Takeovers and Acquisitions: Strategies for Creating Value and Growth,* Tab II at 17 to 30 (Insight Information Co., 2000).

Currently, an offeror is required to assess the true intention behind its purchase of the convertible securities and if such intention is primarily to acquire the underlying shares, the offer for the convertible securities will be characterized as an offer for the underlying shares.[15]

Clause 143(1)(28) of the Act gives the OSC the power to make rules regulating "take-over bids, issuer bids, insider bids, going-private transactions and related party transactions". Given that it could be clearer that a "take-over bid" can include an offer to acquire securities convertible into voting or equity securities, the Team recommends that clause 143(1)(28) of the Act be amended to permit the OSC to make rules in respect of offers to acquire securities that are convertible into voting or equity securities.[16]

## FURTHER STUDY REQUIRED BEFORE ANY LEGISLATIVE AMENDMENT IS UNDERTAKEN

This section of the submission discusses issues for which legislative amendment may be required but which the Team believes further study is required before any such amendment is undertaken.

### *Form of Transaction*

The Commentary to the Notice[17] states that the CVMQ has issued a notice stating that it will be asking the CSA Take-over Bid Committee to consider whether the take-over bid provisions should be extended to transactions that are not structured as take-over bids but that achieve the same result, such as arrangements.

In the Team's view, this is an issue that should be studied thoroughly before any changes are made. On the one hand, it may be tempting to conclude that for those plan of arrangement or amalgamation transactions that are nothing more than disguised take-over bids, substance over form should govern and, therefore, certain fundamental take-over bid rules, such as equal treatment of securityholders,

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[15]In connection with proceedings before the OSC in respect of the proposed acquisition by Noranda Inc. of convertible debentures and warrants to purchase common shares of Falconbridge Limited, the OSC considered the issue whether the term "indirect acquisition" in section 92 of the Act encompassed the purchase of convertible securities, thereby rendering such a purchase a take-over bid. In those proceedings, then OSC Chairman Stanley Beck is quoted as expressing the view that excluding offers to purchase convertible securities from the definition of "take-over bid" would enable offerors "to drive a coach and four" through the basic principles of Part XX of the Act. See P. Koval, "Indirect Offers - The Lessons of Recent Experience" in *Going Private: Asset Swaps, Indirect Takeovers and Coat-tails* (Canadian Institute, 1989). See also Notice - Staff Investigation in Respect of Loan by Stelco Inc. to Controlling Shareholder of Clarus Corporation (1991) 14 OSCB 2030, in which OSC staff discussed the circumstances in which the grant of a loan secured by a shareholder's holdings in an issuer could be considered an indirect offer to acquire the pledged securities.

[16]Convertible securities are subject to the SEC's tender offer rules. It should be noted that Rule 61-501 opted not to deal with convertible securities, leaving their treatment to the terms of the articles or indenture.

[17]See item 29 of the Commentary and Additional Questions accompanying the Notice.

should apply. Consideration also could be given to applying pre- and post-bid integration rules to such transactions, in the same way that they are applied to take-over bids.

On further reflection, however, it may be that the different forms of transaction lend themselves to different rules. For example, in a take-over bid, an offeror can deal directly with the target company's securityholders. Consequently, absent regulation such as an equal consideration rule, a bidder could discriminate amongst securityholders. By contrast, in connection with a plan of arrangement, the transaction is generally negotiated with the target company and approved by its board of directors, who are exercising fiduciary responsibilities. The transaction also must be approved by: (a) a majority of the shareholders at a meeting after receiving full disclosure relating to the transaction; and (b) a court after considering the fairness of the transaction. Furthermore, such transactions generally will confer dissent rights upon securityholders. Clearly, a plan of arrangement contains procedural safeguards that are not present in a take-over bid transaction. Furthermore, it is the flexibility allowed by the plan of arrangement transaction, including the ability to treat shareholders unequally in a formal sense (but fairly in a substantive sense, as evidenced by the shareholders' favourable vote and court's determination of fairness), that enhances the popularity of this form of transaction structure.

The Team also notes that, in reformulating OSC Policy 9.1 as Rule 61-501, the definition of "going private transaction" was changed so that, in general terms, it applies to any transaction where a beneficial owner's interest in a participating security may be terminated without the owner's consent, provided that a related party of the issuer is a party to or is involved in the transaction and is being treated differently than other securityholders. This means that many transactions that provide for unequal treatment of securityholders will be subject to the enhanced disclosure, valuation and minority approval provisions of Rule 61-501.

If it can be demonstrated that the procedural safeguards applicable to plans of arrangement and other corporate transactions, such as amalgamations, are insufficient to properly protect investor interests, consideration could be given to extending regulation to these transactions, either through securities regulation, or by amendment to the corporate statutes. This should be done, however, only after thoughtful and thorough analysis.

***Remedies Generally***[18]

Section 104 of the Act confers upon the OSC the power to issue what can be described in very general terms as a "compliance order" if the OSC determines that a person or company has not complied with Part XX of the Act or the Associated Regulations. In addition, regardless of whether

[18]This section is partly responsive to item V.40 of the Notice.

there has been non-compliance with Ontario securities law, the OSC can exercise certain powers under section 127 of the Act if it determines that it is in the public interest to do so.[19]

Section 105 of the Act provides that what is now the Ontario Superior Court of Justice (the "Court") has the power to make an order where the Court concludes that there has been non-compliance with Part XX of the Act or the Associated Regulations. Section 128 of the Act is a general provision conferring upon the Court the power to make an order where it concludes that there has been non-compliance with Ontario securities law. Unlike the OSC's more limited powers, the Court's powers are more comprehensive.

Notwithstanding the fact that the Court's powers are broader than the OSC's powers, the OSC is often the "forum of choice" for participants in M&A Transactions who have concerns about such transactions. Such participants frequently turn to the OSC for a remedy because:

(i) the OSC is able to hear and determine complaints expeditiously, prior to the expiry of a bid or completion of a transaction; and

(ii) the OSC has significant expertise and experience in dealing with the issues that arise in the context of M&A Transactions.

In connection with proceedings initiated by persons or companies involved in or affected by M&A Transactions, staff of the OSC often play a role by, among other things, making submissions to the OSC as to whether it is appropriate for an order under section 104 or 127 to be issued and, if so, what that order should be. In addition, staff sometimes initiates proceedings in respect of M&A Transactions. This may happen, for example, where one or more participants in the M&A Transaction have concerns but cannot realistically assume the burdens associated with initiating court proceedings.

Accordingly, it is essential that the OSC have effective powers that are appropriate to the type of proceedings it conducts in respect of M&A Transactions. Occasionally, however, the question has arisen whether the OSC has the power to provide an appropriate remedy.

Some concerns can be dealt with by amending other provisions in Part XX to impose an obligation upon which a compliance order could be founded.[20] It may be appropriate to deal with certain other

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[19]See, *e.g.*, *Re C.T.C. Dealer Holdings Ltd. and Ontario Securities Commission* (1987) 59 O.R.(2d) 79 (Div.Ct.). Certain other powers set out in section 127, such as the power to require dissemination of an amended disclosure document, can be exercised only if the OSC determines that there has been a contravention of "Ontario securities law".

[20]For example, as discussed in more detail below under the heading "Remedies - Return of Securities", if Part XX is amended to require a bidder to return forthwith any securities that it has taken up but not paid for within the prescribed time period, then clause 104(2)(c) would authorize the OSC to direct the bidder to effect such a return if the bidder did not do so on its own initiative.

concerns, however, through amendments to, or clarifications of the scope of, sections 104 and 127.

For example, in *Re Med-Tech Environmental Ltd.*,[21] the OSC concluded that a bidder could not rely upon the private issuer exemption and, accordingly, its bid contravened Part XX of the Act because it did not satisfy the formal bid provisions. The bidder purported to have already taken up and paid for shares tendered to its bid pursuant to share purchase agreements it had entered into with certain shareholders. A superior offer from a competing bidder was outstanding. An issue arose whether the OSC could issue an order under section 104 that would have the effect of enabling shareholders who previously had sold securities to the first bidder to withdraw those shares and tender them either to the competing bidder or to a new offer from the first bidder. The first bidder submitted that only the Court, and not the OSC, could interfere with "vested legal rights" or deal with "past non-compliance" (as opposed to continuing non-compliance) with the Act. The OSC, however, concluded that it could issue an order under clause 104(1)(b) requiring the first bidder to amend documents, *i.e.*, the share purchase agreements, to give the shareholders withdrawal rights.[22]

A similar issue also could arise if, for example, a bidder alleged that the target board had engaged in inappropriate defensive tactics by entering into certain agreements with burdensome change of control provisions. If the bidder sought to challenge the target board's conduct as being inconsistent with *National Policy 62-202 - Defensive Tactics* and requested that the OSC exercise its powers under section 127, a question could arise as to what order the OSC could or should grant to remedy the situation. It may be that the more appropriate forum for dealing with such a matter is the Court.

The adequacy of the powers and remedies available to the OSC, generally, to regulate M&A Transactions is a subject that requires further thoughtful analysis before legislative amendment is considered.

**FURTHER STUDY REQUIRED BUT LEGISLATIVE AMENDMENT UNNECESSARY AS ADEQUATE RULE-MAKING AUTHORITY EXISTS**

This part of the submission discusses a number of issues concerning the regulation of M&A Transactions that the Team believes require further consideration. To the extent that the study of these issues results in the need for regulatory reform, the Team believes that such reform could be effected through the implementation of rules, for which adequate rule-making authority currently exists. These issues are being identified for the Committee to deal with as it sees fit. No action is being requested of the Committee in respect of such issues at this time.

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[21](1998) 21 OSCB 7607.

[22]In support of the OSC's conclusion, it could be argued that the first bidder did not obtain a "vested legal right" in the shares in question because: (a) the share transfer process had not been completed by the time the hearing took place; and (b) the bidder's rights in the shares were qualified by the vendors' withdrawal rights, which had not yet expired since they had not received take-over bid circulars from the first bidder in connection with the sale of their shares.

***De Minimis Exemption***

The increasing popularity of global investing raises an issue in the context of Part XX of the Act. Currently the *de minimis* exemption for take-over bids and issuer bids has a "fifty registered holder/2% threshold". That is, in order for these bids to be exempt from the Act, the target company must have, in Ontario, fewer than fifty registered shareholders holding less than 2% of the outstanding securities of the particular class. As well, the bid must be made in compliance with the laws of a jurisdiction that is recognized by the OSC. Recognized foreign jurisdictions currently include the United States and the United Kingdom.[23] Given the increasing tendency of Ontario residents to invest in non-Canadian issuers, the fifty holder/2% rule may be too narrow.

The SEC recently has adopted its new cross-border rule,[24] which would permit take-over bids and issuer bids to be made to U.S. residents in accordance with home country rules, provided that the consideration offered to U.S. residents is substantially similar to the consideration being offered in the home country and U.S. residents beneficially own less than 10% of the outstanding securities of the class.

This rule was adopted by the SEC to facilitate the receipt by U.S. holders of bids made for non-U.S. issuers. Offerors previously were not extending such bids to U.S. holders on the basis that the cost of regulatory compliance outweighed the benefits.

Consideration should be given to following the U.S. lead in this area. In addition, consideration should be given to raising the *de minimis* thresholds contained in Rule 61-501 in respect of going private transactions and related party transactions. The current threshold under Rule 61-501is also 2%.[25]

***Financing***

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[23]OSC Recognition Order 62-904 also recognizes British Columbia, Alberta, Saskatchewan, Manitoba, Quebec, Nova Scotia and Newfoundland.

[24]*Cross-Border Tender and Exchange Offers, Business Combinations and Rights Offerings*, 17 CFR Parts 200, 230, 239, 240, 249 and 260; SEC Release Nos. 33-7759; 34-42054, International Series Release No. 1208 (October 22, 1999) (effective as of January 24, 2000).

[25]This issue was flagged as worthy of revisiting when the OSC finalized Rule 61-501. See (2000) 23 OSCB 965 at 968-9. Rule 61-501 only has the 2% threshold (the "number of securityholders in Ontario" ceiling was dropped when Policy 9.1 was reformulated). See paragraphs 4.1(1)(c) (going private transactions) and 5.1(2)(c) (related party transactions) of Rule 61-501. The Team is considering the issue whether Rule 61-501 should be amended to raise the 2% threshold for the *de minimis* exemption, *e.g.*, to harmonize it with any amendments to the *de minimis* exemptions for bids in the Act. The Team also believes that other instruments that apply to M&A Transactions (*e.g.*, *National Policy 48 - Future-Oriented Financial Information*) should be reviewed in order to: (a) determine whether such instruments have, or should have, *de minimis* exemptions; and (b) if so, what the ceilings for those *de minimis* exemptions would be. The Team also believes that consideration should be given to whether certain other jurisdictions should be recognized for purposes of the *de minimis* exemptions for bids in the Act.

Section 96 of the Act requires that, where a take-over bid or issuer bid provides for cash consideration, adequate arrangements must be made “prior to the bid” to ensure that the required funds are available to effect payment in full for all securities that the offeror has offered to acquire.

In connection with a recent unsolicited take-over bid, it became apparent to the Team that this financing requirement often is being interpreted either aggressively or conservatively, depending on the parties’ needs. The issue did not go to a hearing since the issue became academic once a white knight surfaced. The Team concluded, however, along with staff of the Quebec, Alberta and B.C. securities commissions, that the financing requirement required further consideration.

The Team believes that, at one extreme, certain practitioners take the view that as long as the financing conditions match the bid conditions, the financing requirement has been met. Proponents of this view would go so far as to suggest that if a hostile bid was conditional on the performance of due diligence and so was the financing, the financing arrangement would be adequate since take-up would occur only upon completion of satisfactory due diligence.

At the other extreme, certain practitioners seem to take the view that the financing requirement has not been met unless the lender is prepared to “write the cheque” before the bid commences. Proponents of this view would take the position that the financing of a hostile bid, where the financing was subject to due diligence, would clearly be inadequate.

In connection with the bid referred to above, the Team and staff of the Quebec, Alberta and B.C. securities commissions would have been satisfied with the bidder’s arrangement for financing if those arrangements:

(i) were not subject to lender due diligence;

(ii) were the subject of a binding commitment letter where all the material terms were set out, notwithstanding that the commitment letter would still have to be converted into formal customary and mutually agreeable documentation;

(iii) were subject to the minimum tender condition being satisfied; and

(iv) were subject to a material adverse change condition, as well as a “market out” condition in the event of a severe market meltdown.

In other words, the Team would have been prepared to accept some conditionality in the financing, but such conditionality would have to have been customary and minimal.

This recent experience suggests to the Team that further guidance should be given as to what constitutes “adequate” financing arrangements. Before such guidance is given, however, the issue should be thoroughly analysed. The ultimate policy decision should take the following factors, among others, into account:

- What level of conditionality, if any, is necessary in order for financing to be available at an acceptable cost?

- Should the financing requirement focus on ensuring that the funds are secured before take-up as opposed to launch? In this context it should be noted that the U.S. focuses on take-up while the U.K. focuses on launch. The choice made here will have an impact on the relative ease or difficulty of commencing a bid.

***Bid Conditions***

The same bid referred to above has caused the Team to reconsider the issue of bid conditions.

The Act no longer imposes any restrictions on the conditions that can be attached to a bid. The Practitioners' Report stated:

> "While this may lead to an offeror attaching specific or unique conditions to its take-over bid, we believe that offeree security holders and the marketplace will recognize arbitrary or one-sided conditions as such and respond accordingly. The marketplace will determine the type of conditions that an offeror will be able to place on its bid."[26]

While the Team generally agrees with this view, the Team is concerned that the level of conditionality of bids in Canada may be increasing to the point of concern. For example, the recent bid referred to above was initially conditional on completion of satisfactory due diligence by the hostile bidder of the target. A purist could take the view that due diligence in a hostile bid is an oxymoron. The Team was unaware of such a condition ever having been attached to a Canadian offer before.[27] With the encouragement of the Team and staff of the Quebec, Alberta and B.C. securities commissions, the bidder dropped this condition.

Although the OSC should be careful not to impose regulatory restrictions that will make it unduly onerous to launch a bid, the OSC also should be concerned if frivolous bids are being launched, inasmuch as they can move the market and also engage a target company and its board in an unproductive exercise. Although this may be an area where the market will work it out, it should be noted that the U.K. engages in light-handed regulation of conditions by requiring that the satisfaction or failure of a condition be capable of objective determination. For example, it would be inappropriate to condition an offer on the target's annual results being satisfactory. On the other hand, it would be acceptable to condition an offer on the target's annual revenues being at least $300 million.

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[26]*Supra*, note 3 at 23-24.

[27]By contrast, hostile bids often contain a condition that the bidder be afforded the same due diligence opportunity as provided to other potential bidders.

The SEC takes a similar view. The most recent articulation of the SEC view on bid conditions is as follows:

> "Conditions to the Offer: It is important for security holders to be able to evaluate the genuineness of the offer. We believe therefore that a tender offer can be subject to conditions only where the conditions are based on objective criteria, and the conditions are not within the bidder's control. If the conditions are not objective and are within the bidder's control (e.g., the offer may be terminated for any reason or may be extended indefinitely), we believe the offer would be illusory and may constitute a fraudulent, deceptive or manipulative practice within the meaning of Section 14(e)...."[28]

The Team recommends that further consideration be given to whether the OSC should make a rule prescribing the conditions to which an offer to acquire may be subject.

***Defensive Tactics***

While recognizing the need for a target company's board of directors to exercise its fiduciary duties in responding to an unsolicited take-over bid, the CSA, through National Policy 62-202, have indicated their willingness to intervene in cases where defensive tactics are improperly used on the basis that, ultimately, shareholders should have the right to accept or reject a bid.

The Team is considering whether the current regime of "potential intervention" strikes the right balance. On a comparative basis, the U.K. has a "no frustration rule", which has been included in the Common Position on the Directive on take-over bids adopted by the European Union's Council of Ministers on June 19, 2000.[29] The no frustration rule effectively precludes a target company from engaging in defensive tactics unless such tactics receive shareholder approval. By contrast, defensive tactics have been left to judicial discretion in the U.S., particularly the Delaware courts, where a great amount of deference is paid to the target board's judgment.

With respect to defensive tactics, the OSC and CSA have been most active in the area of poison pills. *Re Royal Host Real Estate Investment Trust*,[30] the most recent decision of the Ontario, Alberta and B.C. securities commissions, indicates that the OSC has adopted a flexible, relevant factor approach to determining whether or not it is time for the pill to go in any particular case. The attractiveness

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[28] *Supra*, note 13.

[29] The European Commission's *Proposal For a 13th European Parliament and Council Directive on Company Law Concerning Takeover Bids* will now be sent back to the European Parliament for second reading. The European Parliament approved a first reading of the Directive on June 26, 1997 and the Commission presented an amended proposal on November 10, 1997.

[30] (1999) 22 OSCB 7819.

of this approach is its flexibility and the fact that the OSC makes decisions on a case-by-case basis. A drawback of this approach, however, is that it may create uncertainty for bidders, targets, investors and potential white knights about the amount of time that a target will have to respond to a bid. It also uses OSC resources: the Team spends a significant amount of time dealing with requests for hearings, and the hearings that do take place involve Commissioners, the Secretary's Office, OSC staff litigators and OSC facilities.

Perhaps the *status quo* (*i.e.*, the flexible, relevant factor approach) is sufficient in this area. The Team wonders, however, whether it is worth giving up some flexibility to have a clear standard defining how much time a target board has to respond to an unsolicited take-over bid. If such a rule provided for a longer deposit period for bids than the 35-day period contemplated by the Zimmerman Amendments, would the rule deter unsolicited bids or would bidders conclude that the benefits of a certain rule outweigh the disadvantage of a longer deposit period?

Some people have suggested that the Zimmerman Amendments, when proclaimed, will provide target boards with sufficient time to respond to unsolicited bids so that poison pills will cease to have any legitimate function. The Team, however, does not believe that the Zimmerman Amendments will eliminate poison pills from the Canadian corporate landscape. For one thing, the Zimmerman Amendments have added, at most, four days to the time period provided to the target board to come up with a value-maximizing alternative in the case of an unsolicited bid.[31] The Team believes that corporate Canada will still be of the view that securities laws do not always provide the target with sufficient time to properly maximize shareholder value.

It also should be noted that, even if the legislation was amended to specify the period a target board has to respond to an unsolicited bid, such a change would not necessarily render poison pills useless. Another stated purpose for the adoption of poison pills is to preclude acquisitions of more than 20% of a target company's shares, without an equal offer being made to all target shareholders. Thus, as long as Part XX of the Act continues to exempt certain "acquisitions by private agreement" and "creeping" acquisitions from the take-over bid rules, proponents of poison pills will continue to have a justification for their utility.

The area of defensive tactics may well be beyond the scope of the Committee's mandate. The area is raised, however, because it continues to be controversial and may well benefit from further study and analysis.

[31]Presently, a take-over bid is commenced on the date it is mailed to offeree securityholders. The bidder cannot mail the bid to securityholders until it obtains a current shareholders' list from the target. Under corporate law, a target generally has 10 days to respond to the bidder's request for a shareholders' list. Accordingly, the target has at least 10 days' advance notice of an unsolicited bid, plus the 21-day bid period, to come up with a value-maximizing alternative for shareholders, for a total of 31 days. The Zimmerman Amendments permit a bidder to commence a bid by advertisement prior to receiving a shareholders' list. The bid must remain open for 35 days.

***Regulated Communications***[32]

The core disclosure documents used in connection with M&A Transactions are the take-over bid circular, directors' circular, issuer bid circular and, in the case of a voting transaction, the management information circular. Section 122 of the Act makes it an offence to make a material misstatement or omit something material in one of these documents or any other document that either is: (i) required to be filed under Ontario securities law;[33] or (ii) actually submitted to the OSC.[34] In the area of M&A Transactions, however, the Act provides for a statutory civil right of action for misleading or inadequate disclosure only in respect of take-over bid circulars, directors' circulars, issuer bid circulars and notices of change or variation.

In the context of M&A Transactions, particularly hostile M&A Transactions, however, there is frequently extensive communication by the offeror and the target that is not currently regulated. This includes media interviews, website postings, analyst meetings, meetings with large shareholders, newspaper advertisements, letters to shareholders and some press releases (*i.e.*, those not filed on SEDAR).

The Team is not opposed to such communications occurring. The Team recognizes that there is extensive interest in and import attached to timely communication in this area. What appears somewhat incongruous to the Team, however, is that statutory liability would attach only to misstatements in disclosure documents submitted to the Commission and not to misstatements in other media, notwithstanding that such media also move markets and affect tendering decisions. It may be that for less sophisticated investors it is the "sound bite" and not the detailed disclosure document that affects their tendering or voting decision.

The SEC recently adopted a rule that would facilitate communication in the context of M&A Transactions while providing for liability in respect of such communications.[35] Such rule also would require the filing of all writings with the SEC.

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[32]This section is partly responsive to items II.19 and II.31 of the Notice.

[33]For example, section 101 of the Act *requires* an acquirer to issue and file a news release and file an "early warning report" in certain circumstances. Material misstatements or omissions in such filings would be subject to offence liability pursuant to clause 122(1)(b).

[34]In the context of M&A Transactions, bidders and target companies sometimes file with the OSC via SEDAR other materials, such as news releases, that, strictly speaking, aren't required to be filed under the Act. These materials, however, would constitute "materials submitted to the Commission" within the meaning of clause 122(1)(b) and, accordingly, material misstatements or omissions in these documents could attract offence liability pursuant to clause 122(1)(a).

[35]*Regulation of Takeovers and Security Holder Communications*, 17 CFR Parts 200, 229 ("Regulation M-A"), 230, 232, 239, and 240; Release No. 33-7760; 34-4205; IC-24107.

This is an area to which further consideration should be given, particularly in light of the likely growth of unregulated communications attributable to technological innovation. Of course, further study and analysis is required before a policy decision is made.

***Delivery of Communications***[36]

The short time frames for delivery of and response to certain documents in connection with M&A Transactions makes it imperative that the delivery and dissemination process be as efficient as possible. For example, in a take-over bid, the target's board of directors must mail its recommendation to shareholders no later than seven days before the bid expires. By way of another example, in certain circumstances a notice of change or variation must be mailed to shareholders and, where such a mailing occurs, withdrawal rights are opened up for a ten-day period after mailing.

The Team has received some anecdotal evidence suggesting that, where M&A documents must pass through the hands of several intermediaries in the tiered holding system before they reach the beneficial owner (and ultimate decision-maker), the beneficial owners do not have sufficient time after they receive such documents to make an informed decision and communicate that decision through the appropriate channels.

The Team also wonders whether shareholders have sufficient time to exercise withdrawal rights when they receive a notice of change, particularly in light of the fact that broker/dealers typically have a financial incentive (*i.e.*, receipt of a solicitation fee from the bidder) to ensure that their client's securities are tendered to a bid and not withdrawn.

In light of these concerns, the Team suggests that several issues require further consideration. First, further analysis should be undertaken to determine whether the tiered holding system or other changes in the marketplace are impeding the rapid delivery of M&A communications and, if so, whether regulatory intervention is warranted[37] or, alternatively, whether the delivery/decision time frames need to be expanded.[38]

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[36]This section is partly responsive to items II.18 and IV of the Notice.

[37]For example, it may be advisable to require the filing on SEDAR of a certificate relating to the timely mailing of M&A documents, or it may be appropriate to impose specific deadlines on intermediaries or others regarding the forwarding of communications.

[38]A related issue concerns the use and meaning of the terms "holder", "securityholder", "beneficial owner" and "registered holder" in Ontario securities law. The meaning of these terms in Part XX of the Act is of particular importance for several reasons. For example, certain exemptions are available only if the issuer has fewer than a specified number of securityholders (the private issuer exemption) or purchases are made from a limited number of securityholders (the private agreement exemption). By way of another example, a bidder is required to make a formal bid to all securityholders in Ontario and deliver the take-over bid circular to securityholders whose last address on the issuer's books is in Ontario. Because most securities of Canadian public companies are now registered in the name of a central depositary, it raises questions about whether the use of these terms should be reconsidered and, if necessary, clarified, in order to ensure that they make sense in a market that has a tiered holding system for securities. The Team

Second, the Team supports regulatory initiatives that facilitate the use of the Internet and other electronic media for delivery and dissemination purposes, provided that there is notice of delivery to the recipient, access of the recipient to the document, evidence of delivery and non-corruption or alteration of the document in the delivery process.

***Early Warning***

Under Part XX of the Act, early warning reporting obligations generally are triggered at the 10% level.[39] That is, every offeror that acquires beneficial ownership of, or the power to exercise control or direction over, or securities convertible into, voting or equity securities of any class of a reporting issuer that, together with such offeror's securities of that class, would constitute 10% or more of the outstanding securities of that class must promptly issue a press release and file a report setting forth prescribed information, including the purpose of the acquisition and any future intention to increase beneficial ownership. In the U.S. the analogous reporting obligation is triggered at 5%.

Prior to launching a bid, a bidder frequently will seek to acquire as many shares as possible without having to make public disclosure. The shares acquired are commonly referred to as a "toe-hold" position. Acquiring a toe-hold position is attractive to a bidder because, generally speaking, such shares can be acquired more cheaply than pursuant to a bid. If the bid succeeds, the bidder's average acquisition cost per share will be lowered. If a competing winning bid emerges, the first bidder can tender into the competing bid and either make a profit or use the proceeds to defray the costs of launching its bid.

In 1990, the CSA requested comments on whether the 10% threshold should be lowered to 5%.[40] The comments received were mixed.

Proponents of a higher threshold would argue that it is important to provide an incentive to bidders who launch hostile bids, given the transactional uncertainty and high costs frequently associated with hostile offers. The Team has received several complaints, however, expressing concern about the fairness of allowing a prospective bidder to acquire shares in the market from unsuspecting shareholders who the next day discover that they would have been able to receive a premium for their shares had they known about the imminent bid. Lowering the threshold (either across the board

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believes that, in connection with the five year review process, consideration should be given to adopting consistent terminology so that it is clear when the Act and subordinate instruments are intended to refer to beneficial owners versus registered owners of securities. Alternatively, the terms "holder" and "securityholder" could be clarified where they are used in Part XX of the Act and the Associated Regulations.

[39]The reporting threshold is lowered to 5% for any reporting issuer that is the subject of a formal bid. This lower threshold applies once the formal bid is made until it expires. See section 102 of the Act.

[40]Proposed Changes to Provincial Securities Legislation - Take-Over Bids (1990) 13 OSCB 2295 at 2298-2300 (the "1990 Notice").

or solely for persons intending to make a take-over bid) would not eliminate this concern but it would reduce for shareholders the risk that they may end up selling their shares to the bidder just before it makes a premium offer for the shares.

In connection with toe-hold accumulations, issues also have arisen with respect to whether, and when, the prospective bidder is in possession of material non-public information (*e.g.*, regarding the proposed bid) so as to preclude it from purchasing additional shares. There also is an issue as to who should be able to participate in the potential profit associated with the toe-hold, *e.g.* should it be confined to the bidder only?[41]

The Team is of the view that these issues should be revisited and carefully assessed so that the correct policy decision is made.

***Meaning of "acquisition" and "acquire" in Part XX***

While Part XX deals primarily with purchases of outstanding securities (*i.e.*, purchases in the secondary market), certain obligations in Part XX are triggered by the acquisition of securities from treasury. For example, clause 93(1)(b) of the Act, which provides an exemption from the take-over bid rules for certain "normal course" purchases of up to 5% of a class in any year, requires the bidder to include "acquisitions otherwise made" by it and its joint actors in the preceding 12-month period when it determines whether this 5% ceiling has been exceeded. The Team believes that the phrase "acquisitions otherwise made" encompasses purchases from treasury.[42] Likewise, the early warning provisions in sections 101 and 102 of the Act apply where an offeror "acquires" beneficial ownership of, or the power to exercise control or direction over, or securities convertible into, a specified percentage of a reporting issuer's voting securities or equity securities. These provisions also apply to an acquisition of treasury securities.

The Team believes, however, that certain practitioners are not interpreting the terms "acquisition" and "acquire" in the provisions cited-above as applying to acquisitions from treasury. Accordingly, consideration should be given to clarifying the interpretation of these provisions.[43]

***Disclosure of Change of Control Provisions***

Since the Team was established, the market for corporate control has been extremely active. A recurring issue that has surfaced is the adequacy of public disclosure of agreements, arrangements

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[41]See, *e.g.*, *Re Canadian 88 Energy Corp.* (1997) 20 OSCB 5247 (settlement).

[42]The OSC has granted a number of orders that have the effect of permitting an offeror to exclude prior purchases from treasury in certain circumstances, so that it can effect normal course purchases in the future. See, *e.g., Re Canadian Pacific Hotels and Resorts Inc.* (1999) 22 OSCB 5134.

[43]Consideration should also be given to amending the word "bid" in sections 197 and 198 of the Associated Regulations.

or understandings that could affect corporate control (collectively, "Control Provisions").[44] Examples of such agreements would include:

- (i) shareholder agreements
- (ii) voting trust agreements
- (iii) lock-up agreements
- (iv) support agreements
- (v) agreements with material change of control provisions

Currently, the disclosure obligations in respect of such agreements may be inadequate.[45] Proponents of less public disclosure in this area would argue that these agreements may contain competitively sensitive information and are less material to the shareholder than they are to a prospective hostile bidder, who can generally obtain access to them upon being granted access to the data room. Proponents of enhanced disclosure of these agreements would argue that corporate control is a key element of share price and any agreement that could materially affect control should be disclosed. Furthermore, given the ability to file electronically via SEDAR, certain of these agreements could be filed in their entirety.[46] Requiring such disclosure could facilitate the launching of unsolicited take-over bids and the requirement of public disclosure could have a moderating effect on the terms of such agreements. The Team believes that this issue warrants further consideration and study in connection with the securities regulation of M&A Transactions.

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[44]The Air Canada/Airco, Rogers/Group Videotron/Quebecor/Caisse and Gazit/Centrefund disputes are recent high profile examples.

[45] The forms applicable to the offeror's circular and the target directors' circular (Forms 32 and 34, respectively) do not expressly require disclosure of Control Provisions. Both forms, however, contain a general disclosure requirement obliging the offeror and target's directors, respectively, to "state the particulars" of any information known to the offeror or target's directors, as the case might be, that "would reasonably be expected to affect the decision" of securityholders to accept or reject the bid. (The offeror is not required to disclose such information unless it has not been previously generally disclosed.) This very general requirement confers a great deal of discretion upon the persons preparing the form to decide whether, and in how much detail, to disclose a Control Provision. Prior to a bid, a reporting issuer might conclude that the entering into of a Control Provision constituted a material change in its affairs requiring disclosure pursuant to section 75 of the Act. Form 27 (Report of Material Change) requires a description of the material change that is sufficient to enable the reader to appreciate the change's significance without reference to other material. Issuers sometimes attach Control Provisions to the Form 27 (*e.g.*, a shareholder rights plan), but the filing of such documents is not mandatory. As well the information required in a prospectus (Form 12) includes the particulars of every "material contract" entered into in the 2 years prior to the date of the preliminary prospectus.

[46]Since 1993, the SEC has required domestic issuers to electronically file documents on the EDGAR database. Pursuant to Regulation S-K, the SEC requires material contracts to be filed as exhibits to Form 10Q (quarterly report) and Form 10K (annual report) if such material contracts are executed or become effective during the reporting period reflected by the respective forms. Exhibits cannot be filed in paper format unless a hardship exemption is granted.

***Refining Disclosure Requirements***

The Team also is considering a number of issues relating to the type of disclosure that is prescribed for take-over bid, issuer bid and directors' circulars. Some of these issues include the following:

(i) Presently, when a bidder offers shares in a take-over bid or issuer bid, the form specifies that the bidder should include "the information prescribed by the form of prospectus" appropriate for the bidder or other issuer whose securities are being offered as consideration in the bid. It isn't always clear exactly which of the requirements applicable to an issuer offering securities under a prospectus are incorporated by reference into the take-over bid and issuer bid forms. Even if it is clear that a prospectus disclosure requirement applies, it isn't always clear how certain references in the prospectus form (*e.g.*, to provide information with respect to a period calculated in reference to the date of the receipt for the preliminary prospectus) should apply in the context of a bid. Would it be helpful to prescribe in more detail which prospectus disclosure requirements apply, and how, in the context of a bid?

(ii) Currently, in connection with M&A Transactions such as amalgamations and arrangements that are not subject to the take-over bid rules but do provide for the issuance of securities, there are no detailed requirements to provide prospectus-level disclosure. The issuer merely is instructed to include in the management information circular sufficient information to permit securityholders to form a reasoned judgment of the matter. The OSC, however, recently published for comment proposed *OSC Rule 54-501 - Prospectus Disclosure in Certain Information Circulars* ("Proposed Rule 54-501").[47] Proposed Rule 54-501 would require information circulars regarding transactions in which securities would be issued to include "the disclosure that would be required in a prospectus". The Team believes that consideration should be given to: (a) elaborating upon Proposed Rule 54-501 to prescribe in more detail which prospectus disclosure requirements apply, and how, in the context of transactions involving the issuance of securities where an information circular is sent to securityholders; and (b) harmonizing disclosure requirements for all M&A Transactions in respect of securities offered as consideration in connection with the proposed transaction.[48]

(iii) The Team often receives inquiries from offeree securityholders who have some knowledge of the basic take-over bid rules and are wondering why the bidder appears to be deviating from those rules (*e.g.*, the requirement to treat all securityholders identically). Would investors benefit from a provision requiring disclosure of: (i) any automatic or discretionary exemptions a bidder is relying upon, or proposing to rely upon; and (ii) the consequences for the bid if discretionary relief is not forthcoming?

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[47](2000) 23 OSCB 1979.

[48]The Team notes that the SEC recently adopted a single disclosure form, Schedule TO, which governs disclosure requirements for all M&A transactions.

***Tendering Mechanics***

Critics of tendering mechanics in bids have argued that shareholders should be given, in effect, two opportunities to make a tender decision.[49] According to this view, shareholders should have the benefit of knowing the number of shares that were tendered prior to expiry of the bid and, with the benefit of such knowledge, be given the opportunity of tendering their shares for a short period of time thereafter. Proponents of this view argue that it reduces the coercive aspects of the tendering decision by making it easier for shareholders to assess the consequences of not tendering (*e.g.*, understanding the extent to which they could be locked into a minority position, *etc.*). This tendering format is also typically found in "permitted bid" provisions of shareholder rights plans.[50]

Proponents of the *status quo* in tendering mechanics argue that the two-round process should not be adopted as this would eliminate the incentive for shareholders to tender in the first round, resulting in more unsuccessful bids and, ultimately thereby discouraging potential bidders from making bids.[51]

Having considered the issue, the SEC opted for a compromise approach when it adopted its recent tender offer amendments.[52] The SEC has chosen to make a two-round bidding process optional, provided that, if an offeror wishes to provide a second round, the SEC has stated that the decision to have a subsequent offering period would be a material change requiring disclosure five business days before expiration of the initial offering period.

Consideration should be given as to whether a similar change to tendering mechanics should be made under the Act.[53]

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[49]L.A. Bebchuk, "Toward Undistorted Choice and Equal Treatment in Corporate Takeovers" (1985) 98 Harvard Law Review 1693; also see Regulation M-A, *supra*, note 35.

[50]A "permitted bid" is a take-over made by take-over bid circular that complies with certain conditions stipulated in a shareholders right plan. These conditions typically include the following: (a) the bid is made to all holders on identical terms and conditions; (b) the bidder agrees that no shares will taken up under the bid for a specified number of days following the commencement of the bid; (c) the bidder agrees that shares may only be taken up if more than 50% of the outstanding shares held by shareholders other than the bidder and certain related parties have been deposited and not withdrawn; (d) the bidder agrees that shares may be deposited to and withdrawn from the take-over bid at any time prior to its expiry; and (e) *if, on the date specified for take-up and payment, condition c)is satisfied, the bidder agrees to keep the bid open for an additional period (usually 10 days) to permit the remaining shareholders to tender their shares*.

[51]Comments of the Special Committee on Federal Regulation of Securities of the Section of Business Law of the American Bar Association, April 30, 1999, Online:SEChomepage<http://www.sec.gov/rules/proposed/s72898/lifton1.htm>(accessed: May 17, 2000).

[52]*Supra*, note 35.

[53]It should be noted that other provisions of the Act relating to the tender and take-up of securities could be clearer. Given the very technical nature of these provisions, issues relating to the meaning of these provisions are not raised in this submission.

***Remedies - Return of Securities***[54]

Section 95 of the Act specifies when an offeror must take up and pay for securities tendered to a formal take-over bid or issuer bid.[55] Section 95 also provides that tendering securityholders can withdraw securities that have not been taken up and paid for, beginning on the 46th day after the bid was commenced. There is no provision in Ontario securities law, however, expressly requiring an offeror to return securities that it has not paid for within the prescribed period of time.

Where it appears to the OSC that a person or company has not complied with Part XX of the Act or the related provisions of the Associated Regulations, the OSC has the power under section 104 of the Act to direct the person or company to comply, or restrain the person or company from contravening, Part XX of the Act or the Associated Regulations. An offeror that failed to pay for securities taken up under a bid within the prescribed time period clearly would be contravening Part XX. Absent a positive obligation in the Act requiring an offeror to return securities that it has not paid for, however, does the OSC's power to direct compliance or restrain non-compliance, extend to ordering the offeror to return the securities?[56]

The Team recommends that a rule be made to expressly require an offeror, at its own expense, to return securities that it has not paid for within the prescribed time period.

***Pre-bid Integration***

Staff of the OSC previously have taken the view that where a bid is made within 90 days of a prior offer to purchase shares for cash that was not generally available to all, the bid must include a cash

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[54]This section is partly responsive to item V.40 of the Notice.

[55]Paragraph 9 of section 95 currently provides that, subject to certain exceptions, an offeror shall take up and pay for securities deposited under a bid, where all of the bid's terms and conditions have been complied with or waived, no later than ten days after the bid expires. Paragraph 10 of section 95 provides that any securities taken up by an offeror under a bid shall be paid for "as soon as possible, and in any event no more than three days" after they are taken up. Paragraph 11 of section 95 provides that any securities deposited to a bid subsequent to the date on which securities are first taken up shall be taken up and paid for within ten days after such securities are deposited.

[56]In July 1999, the OSC and ASC temporarily cease-traded the take-over bid by MacDonald Oil Exploration Ltd. for Bresea Resources Ltd. shortly before the bid expired. (See *Re MacDonald Oil Exploration Ltd.* (1999) 22 OSCB 5155.) MacDonald Oil claimed that it took up shares under the bid before the cease-trade order, which prohibited MacDonald Oil from issuing its own securities as consideration under the bid as well as prohibiting it from trading in Bresea shares, took effect. Following a hearing, the OSC and ASC permanently cease-traded the bid. In addition, although they declined to direct MacDonald Oil to return the tendered Bresea shares, the OSC and ASC prohibited MacDonald Oil and certain other persons and companies from trading in any Bresea shares until the tendered shares were returned to their owners. See *Re MacDonald Oil Exploration Ltd.* (1999) 22 OSCB 6453 (reasons for decision).

alternative that mirrors or is better than the prior purchase.[57] This requirement is clearer in the *Securities Act* (British Columbia) (the "BCSA").[58] The Team believes that this requirement should be clarified and, possibly, refined. For example, it may be appropriate to adopt the B.C. provision (*i.e.*, require the consideration in the bid to be in the same form as and equal in value to the prior transaction), but provide for an automatic exemption where the bidder can satisfy a liquid market test and the value of the share consideration clearly is superior, on a per share basis, to the cash consideration offered in the pre-bid purchase.

***Availability of "Normal Course" Take-over Bid Exemptions***

Several other issues have arisen with respect to the availability of the "normal course" take-over bid exemption provided for in clauses 93(1)(a) and (b) of the Act.

First, it has been suggested to the Team that clauses 93(1)(a) and (b) can be read cumulatively to enable an offeror to acquire the maximum percentage of securities permitted under stock exchange rules governing normal course bids in reliance upon clause 93(1)(a), plus an additional 5% in

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[57]See, *e.g.*, J.A. Geller, "New Code for Take-Over Bids in Ontario", in *The Corporation and the Institutional Investor: New Directions in Institutional Power Play* at Tab C-1 to C-11 (The Canadian Institute, 1989); and Cathy Singer, "Mergers and Acquisitions", in *Dialogue with the OSC* at Tab 5 (Riley Information Services Inc., 1997).

[58]Subsection 94(5) of the Act states:

> "Where a take-over bid that is a formal bid is made by an offeror and, within the period of ninety days immediately preceding the bid, the offeror acquired beneficial ownership of securities of the class subject to the bid pursuant to a transaction not generally available on identical terms to holders of that class of securities,
>
> (a) the offeror shall offer consideration for securities deposited under the bid at least at the highest consideration that was paid on a per security basis under any of such prior transactions or the offeror shall offer at least the cash equivalent of such consideration; and
>
> (b) the offeror shall offer to acquire under the bid that percentage of securities of the class subject to the bid that is at least equal to the highest percentage that the number of securities acquired from a seller in such a prior transaction was of the total number of securities of that class beneficially owned by such seller at the time of the prior transaction."

Subsection 103(1) of the BCSA states:

> "If a takeover bid that is a formal bid is made by an offeror and, within the period of 90 days immediately preceding the bid, the offeror acquired beneficial ownership of securities of the class subject to the bid pursuant to a transaction not generally available on identical terms to holders of that class of securities,
>
> (a) the offeror must offer (i) the consideration for securities deposited under the bid at least equal to *and in the same form* as the highest consideration that was paid on a per security basis under any of such prior transactions, or (ii) at least the cash equivalent of such consideration, and
>
> (b) the offeror must offer to acquire under the bid that percentage of securities of the class subject to the bid that is at least equal to the highest percentage that the number of securities acquired from a seller in such a prior transaction was of the total number of securities of that class beneficially owned by such seller at the time of the prior transaction." (Emphasis added)

reliance upon clause 93(1)(b). The Team does not concur with this view, given that, as noted above, clause 93(1)(b) requires the offeror to aggregate acquisitions under clause 93(1)(b) with all "acquisitions otherwise made" in determining whether the 5% ceiling has been exceeded.

Second, another question arises whether an offeror that is making "normal course purchases" through the facilities of a recognized exchange can choose to rely upon either clause 93(1)(a) or 93(1)(b), depending on whether the "counting rules" of the recognized exchange or clause 93(1)(b) produce a better result for it.[59] It might be argued that, if the offeror is acquiring the securities through the facilities of a recognized exchange, it can only look to the exchange's normal course bid exemption and not clause 93(1)(b). Alternatively, it might be argued that there is nothing in Part XX to suggest that the drafters intended to restrict the availability of clause 93(1)(b) to bids made otherwise than through the facilities of a recognized exchange. Clarification of this matter (*e.g.*, through a rule) would be helpful.

Third, a question arises whether a significant shareholder must include purchases by an issuer (*e.g.*, pursuant to the normal course purchase exemptions in clauses 93(3)(e) or (f) of the Act) in deciding whether the 5% ceiling has been crossed for purposes of clause 93(1)(b). As noted above, clause 93(1)(b) requires a bidder to aggregate purchases in reliance upon clause 93(1)(b) with all "acquisitions otherwise made" in the preceding 12 months by it and anyone acting jointly or in concert with it. Subsection 91(1) of the Act establishes a presumption that every associate and affiliate of an offeror acts jointly or in concert with the offeror. Thus, where an issuer has a 60% shareholder that is making normal course purchases and the issuer itself is making normal course purchases, to what extent does the 60% shareholder have to include the issuer's purchases in its 5% calculation?

***Availability of "Private Agreement Exemption"***

Clause 93(1)(c) of the Act (the "Private Agreement Exemption") exempts from the take-over bid rules certain privately-negotiated purchases of securities from not more than five persons or companies at a premium not exceeding 115% of the market price. In the 1990 Notice, the CSA

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[59]The normal course purchase exemptions require the offeror to determine what percentage of the outstanding securities of the class it has acquired in the preceding 12 months. The TSE's normal course bid rules instruct the offeror to determine the number outstanding securities as of the date of the purchase for which an exemption is needed. Clause 93(1)(b) instructs the offeror to determine the number of outstanding securities at the commencement of the 12-month period (*i.e.*, 12 months prior to the purchase for which an exemption is needed). Accordingly, if the issuer has issued securities in the past year, the TSE's normal course bid rule operates in the offeror's favour, while if the number of outstanding securities has decreased in the past year, clause 93(1)(b) operates in the offeror's favour.

requested comment on a proposal to restrict the exemption's use.[60] Comments were mixed and the legislation was not amended. The Team believes that the issue whether to restrict the Private Agreement Exemption's availability (*e.g.*, by limiting the frequency of its use) should be reconsidered.

The Team believes that certain practitioners may be interpreting this provision aggressively regarding the frequency with which it can be invoked by a bidder in respect of a particular issuer. It also should be noted that this exemption frequently is cited by issuers as one of the reasons for adopting shareholder rights plans - *i.e.*, to preclude the transfer of control in circumstances where not all shareholders are treated equally.

Another issue that arises concerns the phrase "bid made generally to security holders". If a purchase of securities is part of a "bid made generally to security holders", the offeror cannot rely upon the Private Agreement Exemption. In OSC Policy 9.3, the OSC discusses circumstances in which purchases purportedly in reliance upon the Private Agreement Exemption should be linked with formal take-over bids or issuer bids and, therefore, treated as non-exempt bids that should have been made to all. Consideration should be given to formalizing this interpretation in a rule restricting the Private Agreement Exemption's availability in conjunction with formal bids or other M&A Transactions.

***Other Issues - Codifying Certain Routinely-Granted Exemptions***

The Team also is considering whether certain routinely-granted discretionary exemptions should be codified in rules as automatic exemptions. Some of the types of exemptive relief under consideration include the following:

(i) **Dutch auction issuer bids**: Consider adopting a rule exempting issuers from the proportionate take-up and payment requirement and the associated disclosure requirement, so that the issuer can: (a) take up securities only from offerees who tendered at or below the clearing price; (b) return securities tendered by offerees who tendered above the clearing price; and (c) take up, without proration, pre-existing odd lots and odd lots that would be created by prorated take-up under the bid.[61]

[60]The proposal provided that an offeror would only be able to rely upon the exemption once in respect of a given class of securities and all purchases under the exemption would have to be completed within 6 months of the first purchase made in reliance upon the exemption.

[61]Furthermore, in a recent article, Professor Anand argued that the identical consideration rule should be reconsidered in the context of Dutch auction issuer bids. Professor Anand suggests than an issuer should be able to purchase shares in such an issuer bid at the lowest tender prices selected by tendering shareholders as opposed to having to provide the "clearing price" to eligible shareholders. The Team believes this issue warrants further consideration. See A.I. Anand, "Regulating Issuer Bids: The Case of the Dutch Auction" (2000) 45 McGill Law Journal 133.

(ii) **Issuer bids - proportionate tender election**: Consider adopting a rule exempting issuers from the proportionate take-up and payment requirement and the associated disclosure requirement, so that the issuer can effect a bid that permits offerees to elect between tendering a specified number of securities or tendering a proportionate number of securities such that they continue to hold the same proportionate interest in the issuer after the bid is completed.

(iii) **Vendor Placement**: Consider adopting a rule to permit issuers that make cross-border share exchange bids to offer foreign securityholders the cash proceeds from the sale of securities offered as consideration under the bid, rather than the securities themselves.

(iv) **Reorganization with no Adverse Effect on Minority - Issuer Bids**: Consider adopting a rule that would permit issuers to acquire their own securities, directly and/or indirectly, in the context of reorganization transactions that have no adverse effect on the issuer or minority securityholders.

(v) **Put Writing Programs in Connection with Normal Course Issuer Bids:** Consider adopting a rule that would permit issuers to effect put writing programs, in accordance with the requirements of recognized exchanges, in conjunction with normal course issuer bids.

***Business Day***

Part XX of the Act provides that a number of time periods are to be computed with reference to "business days". For example, clause 89(2)(a) provides that:

> "a period of days shall be computed as commencing on the next day following the event which began the period and terminating at midnight on the last day of the period, except that if the last day of the period does not fall on a business day, the period terminates at midnight on the next business day".

When the Zimmerman Amendments come into force, paragraph 10 of section 95 of the Act will provide that a bidder must pay for securities within three business days after taking them up under a bid.

The term "business day" is defined in subsection 89(1) to mean "a day other than a Saturday or a holiday". The term "holiday", however, is not defined in the Act, the Regulation, *Rule 14-101 - National Definitions* or *Rule 14-501 - Local Definitions*. The term "holiday" is defined in subsection 29(1) of the *Interpretation Act* (Ontario) to include, unless the context otherwise requires, certain specified holidays.[62]

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[62]These are Sunday, New Year's Day, Good Friday, Easter Monday, Christmas Day, the sovereign's birthday, Victoria Day, Dominion Day, Labour Day, Remembrance Day and any day fixed by the Governor General or Lieutenant Governor as a public holiday or for a general fast or thanksgiving. In addition, where any day other than Remembrance

In connection with a take-over bid last year that purportedly expired on Wednesday, December 29 (and provided that withdrawal rights could be exercised until midnight on Monday, December 27), the Team had to consider whether the definition of "holiday" in the *Interpretation Act* applied (and, if so, whether the list in the *Interpretation Act* was intended to be exhaustive) or whether the term "holiday" should be given a somewhat broader meaning. If the definition in the *Interpretation Act* applied, Monday, December 27 was a holiday because it was the day following a holiday that fell on a weekend. An issue arose whether December 28 and/or December 29 should be considered "holidays" for purposes of Part XX of the Act because the depositary for the bid and most financial institutions were closed on those two dates. While these dates did not fall within the list set out in the *Interpretation Act*, the statute uses the word "includes" rather than "means" in providing a list of holidays. Accordingly, it might be argued that the list was not exhaustive and that the term "holiday" should be interpreted as including December 28 and 29.

Accordingly, the Team recommends that the Act, or at least Part XX, should incorporate a definition of "holiday" that, for example: (a) makes it clear that the definition in the *Interpretation Act* applies; and (b) also designates as holidays any days upon which either the local stock exchange or chartered banks are closed.

## PROXY REFORM

As indicated in the Notice, proposed amendments to the *Canada Business Corporations Act* have been introduced which are intended to encourage and facilitate communication among shareholders.[63] The SEC has also amended its proxy rules to foster more open communication among shareholders.[64] Upon conducting the necessary study and analysis, consideration should be given to revising the Act and *Business Corporations Act* (Ontario), which to date, have not been affected by this reform process.

## CONCLUSION

The Team has identified a number of issues in the regulation of M&A Transactions that require further consideration.

The Team recognizes that this submission raises a number of issues that may be beyond the scope of the Committee's agenda. The issues are raised, nevertheless, for the Committee to consider as it sees fit. A path forward for the Committee might be to focus on the two issues for which the Team is recommending legislative amendment while leaving the other issues for separate study and analysis.

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Day falls on a Sunday, the next day following is considered to be a holiday.

[63]See item II.28 of the Notice.

[64]*Supra*, note 36.

The Team believes that such separate study and analysis should ultimately be undertaken to ensure that Ontario's regulation of M&A Transactions meets only one standard - the standard of excellence.

The Team would be pleased to elaborate upon or answer any questions that the Committee has in connection with this submission.

Respectfully submitted by the Take-over Bid Team:

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