REGULATION OF TAKEOVER BIDS IN ONTARIO

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ABSTRACT

Takeovers play an important role in the economy as they serve to reallocate economic resources to more efficient uses and replace inefficient management. Unregulated takeover bids pose a threat to the interests of the target company shareholders. The legislature pays special attention to takeover bids to make sure that the *bona fide* interests of the target company shareholders are duly protected. This is the primary purpose of the takeover bid regulation in Ontario. The regulation is also aimed at ensuring the horizontal equity among target shareholders and the efficient functioning of the capital market. This thesis analyzes the present regulation of takeover bids in Ontario and argues that while the whole system of takeover bid regulation is consistent with the proclaimed purposes, there are two issues that fall out of the coherent structure. The restriction on free transferability of shares and the adoption by boards of directors of shareholder rights plans do not enhance the protection of target company shareholders and do not correspond to the proclaimed purposes.

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RÉSUMÉ

Les prises de contrôle jouent un rôle important dans l'économie puisqu'elles permettent de redistribuer les ressources économiques, de les utiliser plus efficacement, et de remplacer les directions incompétentes. Les offres d'achat visant à la mainmise non réglementées menacent les intérêts des actionnaires de la société cible. Le corps législatif prête spécialement attention aux offres d'achat visant à la mainmise pour s'assurer que les intérêts *bona fide* des actionnaires de la société cible soient dûment protégés. Ceci est le premier but de la réglementation sur les offres d'achat visant à la mainmise en Ontario. La réglementation permet aussi d'assurer l'équité horizontale entre les actionnaires cibles et le fonctionnement efficace du marché des capitaux. Cette thèse analyse la réglementation actuelle des offres d'achat visant à la mainmise en Ontario et soutient qu'alors que le système des réglementations sur les offres d'achat visant à la mainmise dans son ensemble est en accord avec les objectifs déclarés, deux élements sortent de la structure cohérente. La restriction portant sur la libre transmission des actions et l'adoption de programmes de droits aux actionnaires par les conseils d'administration n'améliore pas la protection des actionnaires de la société cible et ne corresponde pas aux objectifs proclamés.

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INTRODUCTION

Broadly speaking, a "takeover" takes place when one company acquires control of another company.[1] A takeover may be defined as a transaction or series of transactions whereby a person (individual, group of individuals or company) acquires control over the assets of a company, either directly by becoming the owner of those assets or indirectly by obtaining control of the management of the company.[2] Control may be acquired through a number of techniques, including the purchase of assets of the target company, amalgamation, a proxy contest or an accumulation of the target company stock through the purchase of shares under private agreements with target shareholders or on the open market. The choice of a particular acquisition technique usually depends on the degree of opposition of the target company management.

Based on the degree of cooperation of the target company management, takeovers may be friendly or hostile. The most effective method for the acquisition of control in a hostile situation is a takeover bid. When a takeover bid is made, a general offer is made to all or most shareholders of the target company to purchase their shares under purchase and sale agreements. The consideration offered may be cash, or shares of another company, or a combination of those two forms. As a result, the offeror acquires (or, at least, intends to acquire) a sufficient number of target shares that will enable him to exercise legal or effective control over the target company.

A takeover bid as an acquisition technique is essentially different from other methods of acquisition. As a rule, an acquisition of control is effected with the approval of the target board of directors or the shareholders.[3] In a takeover bid context, neither the approval of the target board of directors, nor the acceptance by the majority of shareholders is required. In fact, the bid is frequently against the wishes of the target

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[1] M. Weinberg & M. Blank, *Weinberg and Blank on Take-Overs and Mergers*, 4th edition, (London: Sweet & Maxwell, 1979), at p. 3.

[2] *Ibid.*

[3] E.g., C.B.C.A. s. 182(5) and 189(3) and (8); O.B.C.A. s. 176(1) and 184(3).

company management. It may also pose potential harm for the target shareholders: the shareholders may be compelled to sell their shares when they do not want to and receive less return on their shares than they might have received in the absence of a takeover bid or under another bid.

Acquisitions have always been an integral part of economic activity. They are particularly frequent in times of economic prosperity. Since 1960s, the number of mergers and acquisitions in the world has grown rapidly. It was caused mainly by a move towards larger industrial and business units with the purpose of increasing the level of productivity and efficiency, satisfying the growing demand towards mass-produced goods, reducing costs, creating companies national or international in scope, and making a better use of scientific research and technological advances.[4] There are also opinions that one of the purposes of acquisitions is to use more intensively good management teams, which are scarce, and displace less effective management.[5] One may agree or disagree whether this is the purpose of acquisitions, but acquisitions are frequently accompanied by the change of management of a less viable company.

Some of the motives for acquisitions can only be implemented through a hostile takeover. In some circumstances, value creation requires changes that will make managers worse off, who then can be expected to oppose them. In other circumstances, managers believe that the market undervalues the target company and resist an offer to protect shareholders from selling for less than the company's intrinsic value. In either event, an acquisition often takes the form of a hostile takeover bid which can be accomplished without the approval of the target company's board of directors.[6]

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[4] *Report of the Committee of the Ontario Securities Commission on the Problems of Disclosure Raised for Investors by Business Combinations and Private Placements* (Toronto: Ontario Securities Commission, 1970) (hereinafter, the "Merger Report"), Appendix IV; Weinberg, *supra* note 1, p. 9.

[5] Weinberg, *ibid.*

[6] R.J. Gilson & B.S. Black, *The Law and Finance of Corporate Acquisitions*, 2nd edition (New York: The Foundation Press, Inc., 1995), p. 730.

Takeovers became widely used in the United States and in Canada in the 1960s. And immediately, with the growing popularity of this acquisition technique, the legislature became concerned of its potential for unequal and unfair treatment of the offeree shareholders and responded with a regulatory framework for takeover bids. The purpose of this thesis is to identify the objectives of legislative regulation of takeover bids at the example of Ontario, to analyze the original and current legislative and common law framework for takeover bids, and to see whether the present regulation is consistent with the proclaimed objectives. The thesis begins with a brief outline of reasons for legislative regulation of takeover bids and describes the proclaimed purposes of such regulation. It then discusses different approaches to takeover bid regulation and presents a brief overview of the debate about the desirability of takeover bid legislation.

The second chapter addresses the introduction and development of takeover bid legislation in Ontario and outlines the most notable amendments to it. The discussion of the initial takeover bid regulation and its gradual development serves as a background for the detailed analysis presented in the next chapter.

The third chapter deals with the current takeover bid legislation in Ontario. It analyses the present definition of a takeover bid, discusses permitted exemptions from takeover bid regulation and attempts to present a thorough review of substantive requirements of the securities law governing takeover bids in Ontario.

The fourth chapter addresses the impact of common law on takeover bid regulation and, in particular, on defensive tactics that may be adopted by target companies. The most notable court decisions with respect to defensive tactics will be outlined and their application in recent decisions by Canadian courts, as well as recent decisions of the Ontario Securities Commission will be reviewed.

In the conclusion an attempt is made to determine whether the present regulation of takeover bids in Ontario attains its purposes and whether the legislative approach should be modified. It will be argued that while protection of shareholders' interests is a worthy objective of state interference in economic relations, the basic protection guaranteed by the state, on the one hand, should take into account economic aspects and be in line with them, and on the other hand, should not disregard other not less important objectives, namely, the equality of all holders of shares of the same class, and should be more consistent with such purposes.

I. TAKEOVER BID REGULATION – RATIONALE AND DESIRABILITY

A. **Rationale Behind Takeover Bid Legislation**

The general rationale behind takeover bid legislation was to protect the investing public by averting potential abuses while impeding as little as possible the use of the takeover bid technique.[7] A number of reasons were brought to justify the adoption of statutory takeover bid regulation.[8] Absent relevant mandatory requirements, there are multiple possibilities for a bidder to abuse the interests of offeree shareholders. One of the threats posed by hostile acquisitions of shares and perceived by the legislature and scholars was the lack of information. When a shareholder does not have sufficient information about the true value of the target company and about all the details of the offer he may not be able to determine whether the consideration offered under the bid is adequate. Consequently, he is unable to make a motivated decision whether to trade his shares, or hold on to them hoping to share the gain that the offeror expects to generate, or trade the shares later to another bidder. The legislation is meant to guarantee that target

[7] *Report of the Attorney General's Committee on Securities Legislation in Ontario* (Toronto: March, 1965) (hereinafter, the "Kimber Report"), paras. 1.06 and 3.07.

[8] See M.R. Gillen, *Securities Regulation in Canada* (Scarborough: Carswell - Thomson, 1998), at pp. 308-312; J.T.D. Courtright, *Securities Regulation of Take-Over Bids in Canada* (Calgary: Carwell, 1985), at p. 1.

shareholders are furnished with sufficient information to permit them to assess the merits of a takeover bid.[9]

Another critical issue is timing. When a partial bid is announced on a first come, first served basis, or when the bid is open for a very short time, a target shareholder bears the risk of either trading his shares too early without having sufficient time and information to assess the offer and, possibly, miss the increased consideration if the bid is amended later and the consideration offered is increased, or trading his shares too late and not being able to sell his shares under the bid at all. To exclude such situations, the legislation is to eliminate first-come, first-served takeover bids by guaranteeing *pro rata* acceptance of shares from all trading shareholders[10] and provide for reasonable periods of time to ensure that the offeree management has sufficient opportunity to provide to offeree shareholders adequate relevant information and recommend their acceptance or rejection of the bid and offeree shareholders are given an opportunity to assess such information and form a reasoned judgement as to whether or not they should sell their shares.[11]

When a target shareholder does not have guaranteed rights to withdraw his shares and the bid is open for an indefinite period of time, the shareholder faces the risk of his shares being locked up indefinitely with the initial bidder, and if a competitive bid emerges later, he may not be able to take advantage of it. Thus, the legislation should also address this issue by providing to offeree shareholders a right to withdraw their shares in the light of a counter offer.[12] In fact, the absence of such a requirement may

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[9]Kimber Report, para. 3.23.

[10]*Ibid*, para. 3.17.

[11]*Ibid*, paras. 3.14 - 3.16.

[12]Merger Report, para. 7.23.

effectively discourage competitive bids as well because by the time when competitive bidders are able to make an offer, most shares have been already locked up.[13]

A potential for shareholders' discrimination is also seen in the fact that when the consideration payable under the bid is subsequently increased, the shareholders who have already deposited their shares are not entitled to it. An offeror who varies the terms of the offer by increasing the price should be obliged by legislation to pay the higher price for shares accepted on the initial as well as the amended offer.[14]

The acquisition of a control block of shares from one or several shareholders with a considerable premium was not initially seen as unfair to other shareholders of the target company holding shares of the same class or requiring legislative intervention.[15] However, later free transferability of shares at a premium without any offer being made to other shareholders was called unsupportable, and another reason for legislative intervention was added, namely, to ensure that any premium paid for a significant portion of voting rights in a company be shared ratably among all shareholders.[16]

Another concern was about the directors of the target company. The directors have access to inside information about the coming bid and may easily abuse such knowledge by either purchasing the target shares before the bid is publicly announced, thus gaining profit unavailable to other shareholders, or simply by resisting a bid favourable to shareholders only for the purpose of entrenching themselves in their current positions. The legislation should try to prevent such abuse by requiring disclosure of the trading by insiders of the offeror and the offeree company in the shares of their respective

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[13]See Gillen, *supra* note 8.

[14]Kimber Report, para. 3.22.

[15]Kimber Report, para. 3.12; Merger Report, para. 7.09.

[16]Report of the Securities Industry Committee on Take-Over Bids, *The Regulation of Take-Over Bids in Canada: Premium Private Agreement Transactions* (Toronto: 1983) (hereinafter, the "Industry Report").

companies. The contents of the takeover bid circular should also provide adequate disclosure on a timely basis.[17]

Several other concerns were put forward, including looting of the target company[18] and the absence of the bidder's obligations to take up the deposited shares or to pay for them on a due date. The latter concern was to be addressed by providing certain time limits during which the deposited shares must be taken up and paid for and after which offeree shareholders should be free to withdraw their shares.[19] All the above reasons justified the necessity of the adoption of takeover bid regulation.

One cannot unequivocally assert that takeovers are inherently good or bad. From the point of view of the free enterprise economy, allowing people to pursue their own economic advantage will ultimately result in the best allocation of the national resources. As regards takeovers, a person of sufficient means who feels that the value to him of the assets of a company is greater than the value placed upon those assets by the existing shareholders, and the investing public in general, should be free to attempt to persuade those shareholders to transfer control of those assets to him. It is inherent in the free enterprise economy that a person who feels that he can make better use of the company's assets should be able to do this. Moreover, the risk of takeovers may be beneficial for target shareholders because of its stimulating influence on slack management of target companies. With the prospect of a possible takeover, the target management may be more motivated to maximize the returns to shareholders so as to prevent the price of shares languishing at a level at which a bid may be attracted.[20]

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[17]Kimber Report, para. 3.08; Merger Report, para. 7.22.

[18]Fischel opposes this argument by saying that if the corporation is well managed, an offeror will not gain anything from the takeover and is not likely to make one. Moreover, "if the liquidation value of an enterprise is greater than its going concern value, the tender offeror renders an economic benefit by liquidating its assets." D.R. Fischel, "Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers" *(1978) 57 Tex. L.R. 1*, at 18.

[19]Kimber Report, para. 3.16; Merger Report, paras. 7.33 - 7.34.

[20]Weinberg, *supra* note 1, at pp. 8-12.

B. Objectives of State Regulation of Takeovers

From the outset, the primary purpose of statutory regulation of takeover bids in Canada is the protection of general investors from the harm a takeover bid may bring to them by averting potential abuses.[21] The legislation is designed to guarantee the protection of the *bona fide* interests of the target shareholders[22] by a number of means. First, shareholders should be entitled to receive sufficient up-to-date information on the basis of which they could form a reasoned decision as to the acceptance or rejection of the bid.[23] In fact, to ensure that the shareholders of the offeree company are given adequate information and a reasonable period of time within which to assess such information is the principal purpose justifying the statutory code regulating takeover bids.[24] Second, the management of the target company should have ample opportunity to inform the offeree shareholders of its analysis of any takeover bid.[25] The management is not entitled to substitute the decision of the offeree shareholders by its own decision. However, it is responsible to furnish the shareholders with sufficient information to permit them to assess the merits of any takeover bid.[26] Therefore, a takeover bid circular should accompany or form part of every takeover bid.[27] Third, it is vitally important that the ultimate decision about any takeover bid should be taken by the offeree shareholders without any pressure either from the offeror or the offeree management.[28]

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[21]Kimber Report, para. 3.07; Merger Report, para. 1.19.

[22]Kimber Report, para. 3.10; National Policy 62-202 - Take-Over Bids - Defensive Tactics (Date: July 4, 1997; 20 O.S.C.B. 3525) (hereinafter, "National Policy 62-202"), s. 1.1(2); Final Report of the Committee to Review the Provisions of the Securities Act (Ontario) Relating to Take-Over Bids and Issuer Bids (1983) (hereinafter, the "Practitioners Report"), paras. 1.01 - 1.02.

[23]Kimber Report, *ibid.*

[24]*Ibid*, para. 3.15.

[25]Kimber Report, para. 3.14; Practitioners Report, para. 1.02.

[26]Kimber Report, para. 3.23.

[27]*Ibid*, para. 3.24.

[28]National Policy 62-202, s. 1.1(2); Practitioners Report, para. 1.02.

The attitude of the legislation towards defensive tactics that may be adopted by target companies is also based on the primary purpose of protecting the *bona fide* interests of target shareholders. Shareholders should not be denied the ability to make a decision with respect to their shares.[29] No defensive action should prevent target shareholders from exercising judgement as to the value and merits of the bid and whether or not to accept it. It does not mean that the target directors should not be entitled to defend against a takeover bid by all persuasive means at their disposal. They may try to persuade the shareholders that the bid is not attractive or that the shareholders will be better off if they do not accept the bid. In any case, a defensive action should not be taken by the directors unilaterally, and the target shareholders should not be deprived of the opportunity to assess the bid and reach their own conclusions.[30]

A constituent part of the primary purpose is the protection of rights of minority shareholders as an essential element of shareholder democracy.[31] At different periods of time different solutions were contemplated to achieve this purpose. Initially, *pro rata* acceptance of shares was recommended.[32] The issue about an equal opportunity for all shareholders to sell their shares at a premium over the market price was raised, but it was resolved to leave it to development by the judicial process.[33] Later, the issue about fairness to minority shareholders was raised again and it was recommended that any premium received by a controlling group of shareholders should be shared ratably among all shareholders.[34] Below, the present approach to this issue will be analyzed.

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[29] *Ibid.*

[30] *Report on Mergers, Amalgamations and Certain Related Matters by Select Committee on Company Law* (Toronto: 1973) (hereinafter, the "Hodgson Report"), pp. 38 - 39.

[31] Merger Report, paras. 7.03 - 7.04; Practitioners Report, para. 1.02.

[32] Kimber Report, para. 3.17; Merger Report, para. 7.26.

[33] Kimber Report, para. 3.12.

[34] The Industry Report.

The second purpose of statutory takeover bid regulation is the horizontal equity among shareholders.[35] All the shareholders tendering under the offer must be dealt with equitably.[36] The Ontario legislation with respect to takeover bids should provide for a concept of equity between one shareholder and another.[37] Equal treatment of all holders of the same class of securities is identified as a fundamental principle of the takeover bid regulation.[38] To achieve equal treatment of shareholders, the legislation should provide for a *pro rata* take up of shares from all tendering shareholders in partial bids. When the consideration offered is changed during the course of the offer, the offeror should be required to pay the same price to all shareholders irrespective of the time when their shares have been taken up.[39] The Practitioners Report also pointed out at the necessity of identical treatment of holders of the same class of securities in transactions which may affect the *de facto* control of public security issuers. It is a matter pf principle that all such shareholders should have an equal opportunity to participate in the benefits which may accompany a change of effective control of public issuers.[40]

The last, but not the least, important purpose of the takeover bid legislation is to lay down good standards of commercial behaviour and general principles of conduct to be observed in takeovers[41] and provide a regulatory framework within which takeover bids may proceed in an open and even-handed environment.[42] It was recognized from the beginning that takeover bids can, in many cases, offer positive advantages to the

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[35]D.P. Stevens, "The Regulation of Takeovers and the Idea of the Corporation" *[1994/95] Meredith Memorial Lectures 371.*

[36]Merger Report, para. 7.01.

[37]Hodgson Report, p. 27.

[38]Practitioners Report, para. 1.01.

[39]Merger Report, para. 7.01.

[40]Practitioners Report, para. 1.02.

[41]Hodgson Report, p. 27.

[42]National Policy 62-202, s. 1.1(2).

companies involved, to their shareholders and to the economy generally.[43] Realizing the need for legislation, the Kimber Committee also noted that the legislation should not unduly impede potential bidders or put them at a disadvantage as compared to the target company management.[44] It is recognized that the takeover bid regulation focuses primarily on bidders and adds complexity to the regulation framework, thus impeding economic efficiencies of the market and imposing direct costs on participants in the takeover bid process and increasing indirect costs resulting from excessive regulation. However, these are costs form part of the regulation which serves to preserve competitive free market forces and capital flows within a climate which honours the principles of investor protection and equal treatment.[45] The protection guaranteed to investors should at the same time permit the capital markets to function with maximum utility.[46]

To summarize, the three main distinctive objectives of statutory regulation of takeover bids in Canada may be observed as: (1) the protection of *bona fide* interests of shareholders of target companies, including the right to information and the right to take a decision with respect to their shares; (2) ensuring horizontal equity among target shareholders, i.e. equal treatment of holders of the same class of shares with respect to consideration received and the proportion of shares taken up; and (3) the regulation of the capital market in Canada aimed at its efficient functioning, protection of interests of public investors and provision of open-handed environment for takeover bids.

In this thesis, it will be analyzed how the Canadian legislation is structured to achieve its proclaimed purposes and whether it is consistent with the objectives it is aimed for.

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[43]Kimber Report, para. 3.03.

[44]*Ibid*, para. 3.10.

[45]Practitioners Report, paras. 1.03 - 1.05.

[46]Merger Report, para. 1.19.

C. **Desirability of Takeover Bid Regulation**

The extensive takeover activity in the United States in the 1980s attracted much attention of American legal scholars. There was a prolonged debate on the economic nature of takeover activity and the advisability of legislative intervention. It is not the intention of this thesis to rehearse that debate in detail as this has been done in detail by many scholars.[47] However, it is important to outline the main arguments made against and in support of legislative intervention in the takeover bid regime.

1. Arguments Against Takeover Bid Regulation

The position of opponents of takeover bid regulation is that the best takeover bid regulation is no regulation at all because any regulation tends to deter takeovers. Easterbrook and Fischel, for example, argue that capital markets are efficient in themselves and adequately reflect the securities' value on the basis of all available relevant information.[48] They argue that takeovers in general tend to be economically favorable because they lead to a more efficient allocation of resources and replacement of inefficient management and maximize shareholder wealth. Management inefficiency will

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[47] Arguments against takeover bid regulation can be found in F.H. Easterbrook & D.R. Fischel, "Auctions and Sunk Costs in Tender Offers" *(1982) 35 Stan. L. Rev. 1*; F.H. Easterbrook & D.R. Fischel, "The Proper Role of a Target's Management in Responding to a Tender Offer" *(1981) 94 Harv. L. Rev. 1161*; D.R. Fischel, "Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers" *(1978) 57 Tex. L. Rev. 1*; A. Schwartz, "Search Theory and the Tender Offer Auction" *(1986) 2 J.L. Econ. & Org. 229*; A. Schwartz, "Bebchuk on Minimum Offer Periods" *(1986) 2 J.L. Econ. & Org. 271*. For arguments in favour of takeover bid regulation see L. Bebchuk, "The Case for Facilitating Competing Tender Offers" *(1982) 95 Harv. L. Rev. 1028*; L. Bebchuk, "The Case for Facilitating Competing Tender Offers: A Reply and Extension" *(1982) 35 Stan. L. Rev. 23*; L. Bebchuk, "The Case for Facilitating Competing Tender Offers: A Last (?) Reply" *(1986) 2 J.L. Econ. & Org. 253*; L. Bebchuk, "Toward Undistorted Choice and Equal Treatment in Corporate Takeovers" *(1985) 98 Harv. L. Rev. 1693*; R.J. Gilson, "A Structural Approach to Corporations: The Case Against Defensive Tactics and Tender Offers" *(1981) 33 Stan. L. Rev. 819*; R.J. Gilson, "Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defense" *(1982) 35 Stan. L. Rev. 51*; J.C. Coffee, Jr., "Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance" *(1984) 84 Colum. L. Rev. 1145*. An overview of the debate can be found in C.S. Ingram, "An Overview and Economic Analysis of Tender Offers and Management's Response to Takeover Threats" *(1989) 54 Missouri L. Rev. 953*.

[48] *Supra* note 18.

be inevitably reflected in the value of the target company's stock. A takeover by an offeror who hopes to improve the corporation's financial health, is beneficial for both, the acquirer and the target shareholders.[49] Management that faces replacement upon a change of control is unlikely to cooperate with the acquirer. A takeover bid, therefore, gives the offeror an opportunity to obtain control over the target company without the cooperation of the incumbent management.

The bidder is subject to substantive disclosure requirements. Fischel argues that no disclosure should be required because it discourages the bidder. A potential bidder identifies a target with weak management through his own efforts and expects to be rewarded for it. The initial bidder should have a property right in privately produced information. Failure to recognize such property right by the society decreases the bidder's incentives to produce such information because the information disclosed by the initial bidder may give subsequent bidders useful commercial information to be used in their bids. Decreasing incentives for the initial bidder leads to the entrenchment of inefficient management and ultimately to the detriment of target shareholders.[50]

Moreover, there is an issue of the cost. The search for a potential target company is rather costly, and these costs are entirely borne by the initial bidder. If a competitive bidder emerges later, he can just free ride on the initial offeror's identification of a suitable target.[51] In addition, complying with legislative requirements also increases costs

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[49] F.H. Easterbrook & D.R. Fischel, "The Proper Role of a Target's Management in Responding to a Tender Offer" *(1981) 94 Harv. L. Rev. 1161*.

[50] Fischel, *supra* note 18, at 9-29.

[51] *Ibid*, at 18-19. Bebchuk, however, disagrees with this argument and agrues that a rule of auctioneering does not eliminate significant returns to searchers. First, searchers have an opportunity to invest profitably in the target they discover by purchasing its shares in the market prior to making a tender offer. Second, a searcher may discover a target that will bring him more synergistic gains than to any other acquirer. Third, because the period for making competitive bids is limited, the initial bidder has more time to study the target. He may also have an informational and strategic advantage. He concludes by saying that search costs are not at all large. See L.Bebchuk, "The Case for Facilitating Competing Tender Offers" *(1982) 95 Harv. L. Rev. 1028*, at 1034-1038.

for the bidder, thus decreasing the incentives for a bidder to make a takeover bid to replace the inefficient management.[52]

The opponents of takeover bid regulation are against the 21-day waiting period guaranteed by s. 95 of the OSA because it makes tender offers less likely to be successful and gives the target management time to engage in defensive tactics. A delay eliminates the element of surprise and gives the target management more time to build up barriers against the offer, thus presenting a threat to the operation of the market for corporate control.[53]

Withdrawal rights give the offeree shareholders an opportunity to trade their shares to a subsequent competitive bid, usually at a higher price. However, a higher price that may be received by the target shareholders under a subsequent bid is offset exactly by the total price paid by the bidder, which is borne by the bidder's shareholders. Thus, an increased price to target shareholders is a transfer of value from the bidder's shareholders.[54]

Takeover bid regulation tends to promote competitive bids that may have a negative effect on target shareholders. The basic law of economics states that when price increases, demand decreases. Raising the price of takeovers ultimately leads to fewer acquisitions and, consequently, to less monitoring of managerial performance.[55]

Bearing all this in mind, a potential bidder, according to the opinion of supporters of the above point of view, will be less willing to make an initial bid, comply with all

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[52] *Ibid*, at 18-19.

[53] *Ibid*, at 28.

[54] Easterbrook & Fischel, *supra* note 49, at 1174-75.

[55] *Ibid*.

disclosure requirements and bear all search costs without a guarantee of ultimate success.[56]

2. Arguments in Favor of Takeover Bid Regulation

There are also proponents of takeover bid regulation who argue that its abolition would give rise to fairness and efficiency concerns. They agree that statutory regulation tends to deter takeover bids. Their position is that while takeovers are presumably beneficial for offerors, often they may not be equally beneficial for the society, and competitive bidding should be promoted. One of their arguments is that takeovers motivated by [improper] reasons contribute little or do not contribute anything to the society and therefore, should be deterred.

A number of reasons are produced to prove that certain takeover bids are not socially beneficial. One of such [improper] reasons may be the current undervaluation of shares of the target company. Sharing the position that capital markets are efficient, the proponents of this point of view say that the takeover merely accelerates an adjustment in the market price that would ultimately occur anyway.[57] Acquisition of such shares may be beneficial for the bidder, but social gains in this situation will be minimum.

Another argument is that the market does not adequately reflect the value of long-term investments and societal concerns that may be pursued by the target management, such as the consideration of the environment, employee health and safety, employee pensions, product safety, charitable contributions, etc.[58] Thus, a switch from undervalued long-term investments to projects generating short-term income that is likely to be made

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[56]Empirical evidence can be produced to support the position that takeover bid regulation deters takeovers. For a comprehensive list of relevant publications see Gillen, *supra* note 8, at p. 340.

[57]Bebchuk, *supra* note 51, at 1033.

[58]M. Lipton, "Takeover Bids in the Target's Boardroom" *(1979) 35 Bus. Law. 101.*

by the bidder aiming only at maximizing his profit should not be supported by the society.

Takeovers may lead to the increase of the market power of the offeror and reduce competition in the market, thus resulting in social efficiency losses. Therefore, takeover bid regulation deterring takeovers should be promoted. Takeovers may be motivated by a mistaken belief of the acquirer that the acquisition of the target company will generate gains. Takeover gains may be produced not by a more efficient allocation of resources, but by expropriations from taxpayers, target customers, employees or minority shareholders.[59]

Another recognized motive for takeovers that do not bring social gains may be the desire of the offeror's managers to increase their power or prestige or decrease risk through diversification, rather than the benefit of the offeror's shareholders.[60]

The target company management should not remain passive when faced with a takeover bid. The legislation should state their proper role which is to provide to the shareholders the information necessary to decide whether to tender their shares, including information on the accuracy of the shares market price prior to the offer and on the value of the offeror's stock if a share exchange is proposed.[61]

The second argument in favor of statutory takeover bid regulation is that while such regulation deters initial bids, it promotes competitive bidding which has potential social efficiency benefits. Competition among potential buyers generally raises the price

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[59]See Gillen, *supra* note 8, at 343-344.

[60]Bebchuk, *supra* note 51.

[61]R.J. Gilson, "A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers" *33 Stan. L. Rev. 819 (1981)*, at 866-867.

a seller will receive.[62] In public companies, shareholders are usually dispersed and unable to bargain with the offeror and insist on receiving some specific share of the gains. In this situation, a potential buyer that does not face competition may acquire the target at a very low premium constituting only a small part of his gains. With a competing offer, target shareholders have a chance of receiving a bigger share of the buyer's gains.[63]

Competitive bidders need time to prepare their offers, especially because they do not receive any information from the target management. Providing a delay the legislation ensures that competitive bidders have sufficient time to advance rival offers, thus increasing premiums in all acquisitions.[64] Potential benefits from competitive bidding also include the increased probability that the target will be acquired by the firm to which its assets are most valued.[65]

In sum, the regulation of offerors is required, and it should be designed to facilitate competing bids. It should guarantee the time necessary for realizing potential benefits from competition among acquirers. As dispersed shareholders are unlikely to cooperate and agree to wait and explore the possibilities of a better offer, the legislation should secure a delay to prevent the shareholders from committing themselves to the initial acquirer.[66] The right to withdraw the shares for some specified time and extension of the period before the bid's effective date both serve this purpose.

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[62]Bebchuk, *supra* note 51, at 1039.

[63]*Ibid*, at 1040.

[64]*Ibid*, at 1045.

[65]*Ibid*, at 1048.

[66]*Ibid*, at 1051-1052.

II. INTRODUCTION AND DEVELOPMENT OF TAKEOVER BID REGULATION IN ONTARIO

Before analyzing in detail the provisions of the initial and subsequent takeover bid legislation, it might be useful to highlight briefly the main lines of protection of offeree shareholders and the means by which legislation guarantees equal treatment of holders of the same class of securities.

The legislation establishes a definite threshold which determines which bids fall under the provisions of the statutory takeover bid regulation. The rules specify the length of time during which a bid must be open and, under certain conditions, the maximum length of time a bid must be left outstanding. Offeree shareholders are entitled to receive a takeover bid circular from the offeror and a directors' circular from the offeree company management providing them with sufficient information about the bid and enabling them to make a reasoned decision. If an offeror makes a partial bid, i.e. a bid for less than all of the shares of a class of securities, and he is offered more shares than he intends to purchase, the offeror must take up the shares offered to him on a *pro rata* basis. If an offeror increases his offer price while the bid is outstanding, all shareholders accepting the bid are entitled to receive the increased price, even if they had accepted the bid before the price was increased. Offeree shareholders are guaranteed a certain period of time during which they are free to withdraw the shares they have tendered. The law establishes a period of time during which the shares tendered under the bid must be taken up and paid for and after which such shares may be withdrawn.

A. The 1967 Securities Legislation - the First Attempt to Regulate Takeover Bids

1. Scope of Application

In October, 1963, the then Attorney General appointed a Committee on Securities Legislation with a task of preparing recommendations for legislative action. The committee, which became known as the Kimber Committee, made a thorough research and the report (hereinafter, the "Kimber Report") that it has produced resulted in the first legislation in Canada regulating takeover bids. Takeover bid provisions were introduced as Part IX of the Ontario Securities Act in 1966 (hereinafter, the "1966 OSA.")[67] The primary purpose of the new legislation was the protection of the *bona fide* interests of shareholders of the offeree company[68] in the situation when a takeover bid technique was used. This the Ontario Legislature has obviously attempted to do. But before looking in detail at the nature of protection offered to shareholders by legislation it is necessary to determine what events trigger this protection.

The 1966 OSA, pursuant to the recommendations of the Kimber Committee, did not attempt to regulate all share purchases that might result in the acquisition of legal or effective control. It saw the potential harm only when a certain technique was used, namely, a takeover bid. Thus, the first legislative definition read as follows:

> 80(g) "take-over bid" means an offer, other than an exempt offer, made to shareholders the last address of any of whom as shown on the books of the offeree company is in Ontario to purchase such number of equity shares of a company that, together with the offeror's presently-owned shares, will in

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[67] S.O.: 1966, c. 142.

[68] Kimber Report, para. 3.10.

the aggregate exceed 20 per cent of the outstanding equity shares of the company.

80(e) "offeror" means a person or company, other than an agent, who makes a take-over bid, and includes two or more persons or companies,

(i) whose take-over bids are made jointly or in concert, or

(ii) who intend to exercise jointly or in concert any voting rights attaching to the shares for which a take-over bid is made.

The definition was structured in such a way so that a potential bidder would know precisely when he comes within the definition. Obviously, this was one of the rationales behind the 20 per cent arbitrary threshold level for the acquisition of effective control. This reflected the policy decision of the Kimber Committee not to regulate the acquisition unless the offeror either already had effective control or was attempting to acquire it. The 20 per cent threshold was chosen by the Kimber Committee as a compromise between the thresholds adopted in other common law countries. In Great Britain, a takeover bid was defined as an offer to buy 51 per cent made to more than one holder,[69] and in the USA a 5 per cent barrier was chosen as requiring extensive disclosure by the offeror.[70] Another basis for recommending this 20 per cent cut off was that this was the point at which "effective, not legal, control" was acquired.[71] Obviously, it is practically impossible to determine the minimal general threshold at which effective control is achieved in any company.[72] It largely depends on the number of shareholders of the company, on the

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[69]Kimber Report, para. 3.09. This threshold was later reduced to 30 per cent. See Weinberg, *supra* note 1, p. 656.

[70]The amendments to the Securities and Exchange Act of 1934, c. 404 (48 Stat. 881), proposed by Senator Williams, were adopted in 1968, Public Law 90-439, 90th Cong., S. 510, July 29, 1968 (82 Stat. 454), and are now known as the "Williams Act."

[71]Kimber Report, para. 3.11.

[72]This 20 per cent threshold is still preserved in legislation, though often criticized. Anisman considers this figure misdirected because it treats control in terms of the ability to defeat a hostile takeover bid, and in doing so the focus of the legislation is diverted from offeree shareholders to the protection of

number of votes attached to the shares of each class, and the degree to which the ownership of its shares is dispersed. Although there were precedents when effective control was achieved below the legislative 20 per cent barrier, the Merger Report also supported this figure as realistic and no change in the definition was recommended.

Originally, four kinds of offers were exempt from the takeover bid definition. Namely:

> 80(b) "exempt offer" means,
>
> (i) an offer to purchase shares by way of private agreement with individual shareholders and not made to shareholders generally,
>
> (ii) an offer to purchase shares to be effected through the facilities of a stock exchange or in the over-the-counter market,
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> (iii) an offer to purchase shares in a private company or in a public company that has fewer than fifteen shareholders whose last address as shown on the books of the offeree company is in Ontario, two or more persons who are joint registered owners of one or more shares being counted as one shareholder, or
>
> (iv) an offer exempted by order of a judge of the High Court designated by the Chief Justice of the High Court made pursuant to section 89...

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offeree management. He points out that the shareholders' needs should be predominant and control should be defined as the ability to influence the policy of a corporation in the conduct of its business. It is difficult to argue that of the two factors, the way in which an offeror will manage a corporation, rather than his ability to fend off a subsequent bid, influences the shareholders' decision whether to tender their shares. The only difficulty here may be that it is practically impossible to establish a definite rule as to at what moment the offeror starts to influence the policy of the company. Absent any definite threshold, any transaction will have to be reviewed on a case-by-case basis, which would require the provision of a lot more documents than are required now and would most likely result in the increased cost of the acquisition and delay. If the cost of the acquisition is increased, the potential benefits to the offeree shareholders will be proportionately decreased, which is contrary to the objective of the legislation regulating takeovers. It is definitely easier and cheaper to review certain individual transactions and in necessary cases to require the offeror to comply with takeover bid regulation at a lower threshold. Anisman, P., *Takeover Bid Legislation in Canada: A Comparative Analysis* (Don Mills, Ont.: CCH Canadian Limited, 1974), at pp. 21 - 27.

The exemption in s. 80(b)(i) was the one that evoked the most criticism. The first issue criticized here was that this exemption could constitute a major gap in the protective coverage afforded to offeree shareholders by legislation.[73] Certain guidance in determining what offer was not made to "shareholders generally" could probably be found in the provisions exempting a company from having to distribute a prospectus where the distribution of its securities was not made to the public. However, it did not provide a reliable test as to how many private agreements should be considered to constitute a general offer. The Merger Report attempted to resolve this difficulty and proposed that the number of private agreements be restricted to fifteen.[74]

Another issue in this exemption that appeared to have a potential for unfairness was the possibility for a controlling shareholder to transfer control in the company without other shareholders' knowing about it and, moreover, the possibility for such a controlling shareholder to receive a premium over the market price of the shares that was not available to other shareholders. To exempt private agreements from the coverage of the legislation was a policy decision of the Kimber Committee, and the Merger Report did not find any reason to change it. They both considered that the doctrine of fiduciary duties of a controlling shareholder towards other shareholders should be left to development by corporate law and the courts. The justification for this exemption can be the following: a shareholder (or a group of shareholders) is free to negotiate with an offeror over the price for the shares, they are under no pressure, thus, there is no inequality of the bargaining position between the two parties, which means that such shareholders do not need the statutory protection of their interests.

The private company exemption in s. 80(b)(iii) can be justified on the same grounds. In companies with a small number of shareholders shares are usually cohesively held, which means that such shareholders have a rather strong bargaining position and

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[73] D. Prentice, "Takeover Bids: Part IX of the Ontario Securities Act 1966" *(1971) 19 Am. J. Comp. L. 325*, at p. 332.

[74] Merger Report, para. 7.10.

can do without the protection of the legislation. However, this exemption was also subject to criticism.[75] First, in a private company there can be as many as fifty shareholders, and there may be circumstances where the shareholders in private companies would be in need of protection. Second, shareholders of a private company would definitely need substantive disclosure when they are offered shares in exchange. But in this situation they seem to be able to take care of themselves as the success of the bid will depend on their consent, and it is in the interests of the offeror to provide them with all the information that they may request.

As referred to above, the primary concern of the legislature in structuring the protection for offeree shareholders was the method of the acquisition. The potential harm of a takeover bid is that it places much pressure on the offeree shareholders whether to accept the bid. Such pressure is absent when shareholders sell their shares in the market. This was the rationale for introducing the stock market exemption in s. 80(b)(ii). Even if market purchases are part of a plan to acquire control of the company, "no special effort is made to force the offeree shareholder to sell," and he bases his decision solely on the market price of the securities.[76]

The exemption in s. 80(b)(iv) was inserted as a "safety valve"[77] in case the other exemptions were not broad enough. The Merger Report made a reasonable recommendation that applications for this exemption should be directed not to the High Court but to the Ontario Securities Commission which seemed to be better equipped for this purpose.[78]

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[75]Prentice, *supra* note 73, at p. 331-332.

[76]Merger Report, para. 7.11.

[77]Courtright, *supra* note 8, at p. 11.

[78]Merger Report, para. 7.17.

2. <u>Protection of Offeree Shareholders</u>

The 1966 OSA provided three main lines of protection for offeree shareholders by:[79] (1) introducing "time for acceptance" rules the purpose of which was to guarantee that shareholders have enough time to take a reasoned decision about the acceptance of the bid; (2) requiring that the offeree shareholders be furnished with sufficient information to assess the merits of the bid; and (3) stipulating that certain conditions form part of the bid terms.

a. *Time for Acceptance Rules*

The recommendation of the Kimber Committee that all takeover bids should be required to be left outstanding for a specified minimum period of time[80] has been followed in the legislation, and s. 81(1) of the 1966 OSA stipulated that all bids had to remain open for at least 21 days. The purpose of this restriction was obviously to give the offeree shareholders adequate relevant information and a reasonable period of time within which to assess such information, to give the target company a period of time to assess, react and respond, and to give rival bidders time to make their bids.

There were other time limits imposed by legislation. The offeror was prohibited from taking up and paying for any shares within the first seven days of the bid,[81] and during the same seven day period offerees had a right to withdraw the shares tendered. These provisions were aimed at the protection of unsophisticated investors who had hastily deposited their shares without receiving more information about the bid and without obtaining a proper investment advice.

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[79]Prentice, *supra* note 73, at pp. 334-346; Courtright, *supra* note 8, at pp. 12-19 .

[80]Kimber Report, para. 3.15.

[81]Time was measured from the time the offer was sent by prepaid registered mail to the offeree shareholders. S. 82 of the 1966 OSA.

The legislation also set the maximum thirty-five day period during which the bid for less than all the equity shares of a class could remain open.[82] It seems logical to impose a restriction of this kind to prevent the offerees' shares from being tied up for an indefinite period of time. The problem here was that this restriction referred only to partial bids which were not defined in Part IX of the 1966 OSA, and where the bid was not a partial one, the legislation remained silent as to the time during which all deposited shares had to be taken up. This could lead to the offerees' shares being locked in indefinitely. This drawback was already noted in the Merger Report, which proposed two solutions as to the bids that were not partial, namely, either giving the offeree the right to withdraw his shares upon the expiration of the stipulated 35 day period, or to require the offeror to take up and pay for all deposited shares at the expiration of the 35 day period, or abandon his offer.

Another interpretation difficulty arose with regard to s. 83(2) which provided that "where a take-over bid for all the equity shares of a class owned by offerees is converted ... to a bid for less than all the equity shares of a class owned by offerees, the take-over bid shall be conclusively deemed to be for less than all the equity shares of a class owned by offerees." What happens when an initial 100% bid takes up shares pursuant to s. 81(4) within 14 days of the 21 day restrictive period and then becomes a partial offer? Will the offeror be required to return shares already taken up? As well, it was not clear how the time periods would be calculated in such a situation, namely, whether the newly amended bid was to start the time periods in s. 81 running from the beginning as if it were a new bid. One proposed solution was to prohibit any alteration in the terms of a bid for the initial 14 days, and then treat any alteration as conversion of the bid into a partial one in respect of those shareholders who subsequently tendered their shares.[83] But an easier and more reasonable solution would be to state that shares taken up need not be returned or in

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[82]S. 81(5) of the 1966 OSA.

[83]Prentice, *supra* note 73.

any way affected by the conversion of the terms other than price.[84] This solution would give the offeror space for maneuvres and at the same time would not be to the detriment of shareholders: changes in the bid conditions would not prejudice the shareholders who had already tendered their shares as they would still have a right to receive the final price.

b. *Provision of Adequate Information*

Two sources of disclosure were provided by the 1966 OSA: (a) a takeover bid circular; and (b) a directors' circular. The evident purpose of the disclosure was to furnish the offeree shareholders with as much information as possible to enable them to make an informed decision whether to accept the bid or not. However, while a takeover bid circular was mandatory, a directors' circular was not. Only if the directors themselves chose to express their opinion and give any recommendations to shareholders, they were obligated to present such information to the shareholders in the form of a directors' circular, which had to be approved and authorized by the board of directors. Below are the main requirements referring to these two documents and a discussion of related issues.

- Takeover Bid Circular

The following information was to be included in a takeover bid circular:[85]

(i) the number of securities of the offeree company beneficially owned, directly or indirectly, by the offeror, associates of the offeror, each director and senior officer of the offeror and their associates, and any person or company owning equity shares

[84] R. Falby, "Take-Over Bids and the Ontario Securities Act of 1966" *(1967) 5 Osgoode Hall L.J. 227.*

[85] Ss. 90-93 of the 1966 OSA; Courtright, *supra* note 8, at pp. 14-15.

carrying more than 10 per cent of the voting rights attached to all equity shares of the offeror;

(ii) the number of equity shares of the offeree company traded by the persons or companies named in (i) for six months prior to the date of the bid, including the purchase or sale price and dates of each transaction;

(iii) the particulars of any conditional offer dependent on the minimum number of shares deposited;

(iv) particulars of the method and time of payment for the shares of the offeree;

(v) a statement that deposited shares might be withdrawn for seven days from the date of the bid;

(vi) details of the arrangements in cash bids to ensure funds were available;

(vii) if possible, a summary showing volume and price range of shares of the offeree company in the preceding six months;

(viii) particulars of any arrangement or agreement made or proposed between the offeror and the directors and senior officers of the offeree company; and

(ix) particulars of any information known to the offeror that indicated any material change in the financial prospects of the offeree company since its last published financial statement.

Moreover, if the bid offered consideration in whole or in part in securities, the takeover bid circular was to contain additional information that would be included in a prospectus of a company whose shares were offered.[86] While the information had to be

[86]S. 85(3) of the 1966 OSA.

presented in the form of a prospectus provided in the regulations,[87] an actual prospectus approved by the securities regulatory authorities was not required.

The main criticism of the takeover bid circular contents was that it omitted to require certain very important information. Following the recommendation of the Kimber Committee,[88] in a takeover bid made on a cash basis it was not required to disclose the offeror's identity. The rationale suggested by the Kimber Committee was that the dominant factor influencing the offerees was the price, and requiring the offeror to make extensive disclosure might discourage potential bids and thus, prevent offeree shareholders from receiving benefits.[89]

Neither was the takeover bid circular obligated to disclose the offeror's plans to the target company. While this may be acceptable in a one hundred per cent bid when all shareholders sell their shares and have nothing more to do with the company, it is certainly different with respect to a partial bid, where the offeror that would most probably become the controlling shareholder will influence the investment policy of the company and other shareholders would have to depend on his decisions. This was noted by many commentators,[90] as well as the fact that the requirement in (ix) above, obligating the offeror to disclose any information in his possession indicating any changes in the financial prospects of the target company since the last published financial statement, was almost unworkable. The reason for introducing this requirement was clear: if the directors chose not to give any recommendations to the shareholders, which they had a right to, there was a possibility that shareholders would be left without any information at all, and the prescribed waiting period would not do them any good. However, two

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[87]S. 94(1) of the 1966 OSA.

[88]Kimber Report, para. 3.18.

[89]The Merger Report recommended to change this provision with regard to partial bids and give the offeree shareholders a right to know the identity of the bidder with whom they might be associated. See the Merger Report, paras. 7.31-7.32.

[90]See Prentice, *supra* note 73, at p. 338; Courtright, *supra* note 8, at pp. 15-16.

objections may be raised here. First of all, this was the kind of information that an offeror, being an outsider or a minority shareholder, may not possess, and second, assuming that he possessed such information and was aware that the target company's assets were undervalued, or had in mind a more efficient allocation of the company's resources, it was most unlikely that he would be willing to share such information and make it available to the offeree shareholders and board of directors as well as his competitors.

It was also recommended that the takeover bid circular set out the right of appraisal or mandatory acquisition, where such rights existed.[91]

Another major comment concerned the prior review of the circular by the securities regulatory authorities prior to distribution. The legislation did not require that such prior review be conducted, following the decision of the Kimber Committee[92] motivated by considerations of importance of speed and secrecy for the success of the bid, and consequently, for the benefit of the offeree shareholders. It is true that mandatory filing of the circular with the Securities Commission would cause a certain, maybe considerable, delay in the commencement of the bid, it might probably lead to the information becoming known to the offeror's competitors, thus discouraging the success of the bid. However, there may be other considerations besides speed and secrecy: the 1966 OSA did not provide for any statutory civil liability for misrepresentations in the circular, thus making the offeree shareholders rely on the information furnished by the offeror and depriving them of a statutory action in case the information in the circular was false or misleading.

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[91]Merger Report, para. 7.21.

[92]Kimber Report, para. 3.24.

- Directors' Circular

As it was noted above, the directors of the offeree company were under no legal duty to provide their opinion to the shareholders evaluating the offer made to them. However, if they chose to recommend the acceptance or rejection of the bid, they were required to do it in a prescribed form. The following information was required to be included in the directors' circular:[93]

(i) the number of securities of the offeree company owned or controlled by each director and senior officer of the offeree company and any person or company owning equity shares carrying more than 10 per cent of the voting rights attached to outstanding equity shares of the offeree company;

(ii) a statement as to whether each of the persons or companies named in (i) had accepted or intended to accept the offer;

(iii) if the offeror was a company, the number of securities of the offeror owned or controlled by each person or company named in (i);

(iv) the particulars of any arrangement made or proposed between the offeror and any directors or senior officers of the offeree company;

(v) whether any person or company named in (i) had any interest in any material contract to which the offeror was a party;

(vi) a summary, if reasonably ascertainable and not adequately disclosed in the takeover bid circular, showing volume and price range of the offeree company's shares in the preceding six months;

(vii) particulars of any information known to any of the directors or senior officers of the offeree company that indicated any material

[93]S. 95 of the 1966 OSA.

change in the financial prospects of the offeree company since the last published financial statement of the offeree company; and

(viii) the particulars of any other material fact not disclosed in the foregoing.

The list of required information looks rather broad. However, while there is a requirement for the offeror and its insiders to disclose their holdings and trading in the securities of the offeree pursuant to the takeover bid circular provisions, and for the offeree insiders to disclose their trading in the offeree securities pursuant to the insider trading provisions, there is no requirement for the offeree insiders to disclose their trading in the securities of the offeror, only the total amount of shares owned by them. Such information might prove very useful to the offeree shareholders in helping them to assess the position of their directors, and also it might prevent possible collusion between the offeree directors and the offeror. But absent the requirement that the securities regulatory authorities approve the directors' circular prior to the distribution to the shareholders, it would be equally difficult to catch any false information within it, as it was noted above with respect to the takeover bid circular.

The legislation here followed the approach of the Kimber Committee which viewed the shares as the personal property of the shareholders and did not consider directors to be in the position to give investment advice.[94] This point of view was also shared in the Merger Report, which felt that in the situation when there was no unanimity between the directors it was not appropriate for them to give any advice to the shareholders.[95] But soon after the 1966 OSA came into effect, there were commentators who advocated making the directors' circular mandatory and explained it by several reasons: (a) the major purpose of the directors' circular was not to advise, but to provide information, to give to the shareholders a basis on which they could form their own

[94]Kimber Report, para. 3.13.

[95]Merger Report, paras. 7.27 - 7.30.

decision; (b) even if the directors could not reach agreement as to the desirability of the bid, it would do more good to the offeree shareholders to receive contradictory opinions than no opinions at all.[96] Later, the legislation returned to this issue.

c. *Mandatory Terms to Be Included in Tender Offers*

The first major requirement was set forth in s. 81(7) of the 1966 OSA. Where a greater number of shares were deposited pursuant to the bid than was sought by the offeror, the latter was obligated to take up the shares on a *pro rata* basis according to the number of shares deposited by each offeree. This requirement was in line with the objective of the takeover bid regulatory provisions as, firstly, it eliminated any discrimination among the offeree shareholders as to the time of tendering and minimized the possibility of a hasty decision, and secondly, it enabled all offeree shareholders to equally participate in the bid. This was one of the few provisions of the takeover bid regulatory scheme that did not cause any criticism and it is still preserved in the modern OSA.

A second important condition of all takeover bids was that if at any time during the bid consideration offered by the bidder was increased, each offeree shareholder who has tendered his shares had a right to receive such increased consideration, irrespective of whether his shares had been already taken up and paid for or not.[97] No one can oppose the fairness of this provision. However, this seemingly fair requirement also had a potential problem in it: it could have been difficult to determine whether a bid had expired before the consideration was increased.[98]

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[96]See Prentice, *supra* note 73, at p.349-352.

[97]S. 83(1).

[98]See Courtright, *supra* note 8, at p. 19.

The 1966 OSA did not regulate the conduct of the parties to a takeover, namely, market purchases of the offeree company securities, when the bid was outstanding. Nothing seemed wrong with the offeree insiders or their associates purchasing offeree shares in the market before or after the bid was announced. Shareholders still retained their right to choose a more profitable way to dispose of their shares. But the potential for mischief was not here but in the pre-bid period. The offeree management could have been approached by the offeror before the bid was made public, and on the basis of the insider information they could have started purchasing the offeree shares in the market, thus depriving the offeree shareholders from receiving their benefit from the bid. There were suggestions that the parties to the takeover should be prevented from purchasing the offeree shares in the market from the moment an intention to make the bid was formed,[99] but this proposal appears to be highly unrealistic. Who can determine the moment when an intention to make the bid is formed, even before there is any formal evidence to it, like a protocol of the board of directors? Moreover, such prohibition would affect not only the offeree insiders, but also the potential offeror and prevent him from consolidating a certain amount of shares before making a formal bid. We shall see later how this issue was resolved.

d. *Statutory Liability*

The main criticism of the liability provisions in the 1966 OSA was that it provided only criminal liability for the failure to comply with the statutory requirements. Two concerns arose: (a) absent prior approval of the circulars by the securities regulatory authorities, failures to comply with the statutory requirement might never be discovered; and (b) the offeree shareholders were given no statutory remedy. It might have been possible for the offeree shareholders to have a common law action for fraud or negligent misrepresentation, but there were no good reasons for not giving them also a statutory remedy, like rescission or injunctive relief.

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[99]See Prentice, *supra* note 73, at p. 347.

B. The Merger Report and Resulting Amendments

After its enactment in 1967, the securities legislation regulating takeovers continued to be the subject of close attention of the securities administrators. In 1969, a new committee was appointed by the Ontario Securities Commission (hereinafter, the "OSC") with a view to examine the effectiveness of the present legislative policy regarding consolidations, amalgamations, mergers and takeovers. The Report of the Committee of the Ontario Securities Commission on the Problems of Disclosure Raised for Investors by Business Combinations and Private Placements, produced in 1970 and known as the "Merger Report," became the next major development in the securities regulation in Ontario and in Canada and served as a basis for the reforms of 1971. Below, the principal recommendations of the Merger Report relating to takeover bids and the resulting amendments to the securities legislation are described and analyzed.

1. Private Agreements

The Merger Report considered whether the securities legislation should regulate in any way a premium over the market price paid by a purchaser, usually to a controlling shareholder, through a private agreement and came to the conclusion that the approach of the City Code[100] should not be followed as removing all incentives for entrepreneurship, and this issue should be left to corporate law and the courts. But it recommended to determine that only offers made to not more than fifteen shareholders were private agreements, otherwise they amounted to the general offer.[101] Consistently with this

[100]*The City Code on Take-overs and Mergers*. Under the City Code, the directors who effectively control as well as controlling shareholders represented on the board should not sell that control without obtaining the buyer's undertaking to extend a comparable offer to the remaining shareholders. See Merger Report, para. 7.08.

[101]Merger Report, paras. 7.07 - 7.10, 7.36(1).

recommendation, the private agreement exemption in s. 80(b)(i) (new s. 81(b)(i))[102] was restricted to a private agreement with less than fifteen shareholders.

In the light of the previous recommendation, the second part of the exemption in s. 81(b)(iii), exempting offers in a public company with fewer than fifteen shareholders, was deleted as redundant.

2. Market Purchases

The Merger Report did not see it necessary to deprive a potential offeror of the right to purchase the offeree shares in the market and delete the respective exemption, but regarded a change in control in the target company as important investment information.[103] The solution proposed in the Merger Report was the following: a person acquiring more than 20 per cent of the equity shares through market purchases should be obliged to report this through special type of insider disclosure made within three days of the purchase, and he should report within three days each time his holdings increased by 5 per cent. Moreover, not to extend the 3 day period, it was proposed that for reporting purposes the ownership shall be deemed to pass at such time as an offer to sell was accepted by the purchaser or his agent or an offer to buy was accepted by the vendor or this agent. The legislature followed these recommendations in ss. 109a(1) and 109(2)(c).

The Committee was also concerned about the uncertainty that arose when the offeror stated in the takeover bid circular that the number of shares that he would take under the bid would be reduced by the number of shares he purchased at the market during the bid, probably, at a lower price. Nevertheless, instead of forbidding market purchases during the bid at all, it was recommended that an offeror should be prohibited from reducing his *pro rata* purchases pursuant to s. 82(7) by the number of shares

[102]Further in this Chapter, section numbers correspond to the numbers in the OSA as amended in 1971 (S.O. 1971, c. 31, ss. 22-32).

[103]Merger Report, paras. 7.11 - 7.15, 7.36(3).

purchased in the market.[104] This recommendation was adopted, and a respective wording was added as s. 82(9).

While the offeror was allowed to purchase shares of the target company in the market when the bid was outstanding, it was recommended that he had to explicitly disclose such intention in the takeover bid circular.[105] In the view of the Merger Report, this would enable the offeree shareholders to make a reasoned choice between selling all their shares in the market or tendering them to the offeror at what might be a higher price, but at the risk that not all their shares would be taken up. The Committee did not feel like placing too much restrictions on the offerors which could discourage takeover bids completely, and they saw this as a kind of compromise between flexibility for the offeror and protection for the offeree shareholders. The proposed recommendation was added to s. 82(9).

3. Identity of the Offeror

No change was recommended with respect to cash bids for all shares, but with respect to cash bids for less than all shares the Merger Report changed the policy decision of the Kimber Committee and suggested that the identity of the cash bidder be disclosed.[106] This recommendation was supported by many commentators who all viewed it as fair that the offeree shareholders had a right to know with whom they might be associated as shareholders and who might affect the investment policy of the company. A respective wording was included in s. 92(2).

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[104] *Ibid*, paras. 7.15, 7.36(4).

[105] *Ibid*, paras. 7.22, 7.36(8).

[106] *Ibid*, paras. 7.32, 7.36(14).

4. Takeover Bid Circular

Pointing out the importance of flexibility, the Merger Report did not recommend a prior review of the takeover bid circular by the OSC. However, as a takeover bid circular is important for offeree shareholders, it was recommended was that the takeover bid circular should be approved by the offeror directors, signed and certified in the same manner as required for a prospectus in a share distribution and accompanied by a certified copy of the resolution of the board approving its filing and distribution.[107]

A major recommendation of the Merger Report was to give the offeree shareholders a statutory right of rescission if the circular made either an untrue statement of a material fact or omitted to state a material fact in a misleading way.[108] It also recommended to introduce the liability of the directors for any material false statement contained in a takeover bid circular.[109] It should be recalled that the absence of a statutory right of rescission was much criticized in the 1966 OSA. The legislature readily adopted these amendments and added new sections 99a and 100(3) to Part IX of the OSA.

The Merger Report rejected the suggestion that the offeror be required to disclose his intentions with respect to the target company. However, where the right of appraisal, i.e. the right of the minority shareholders to require their shares to be purchased, or the right of compulsory acquisition, i.e. the right of the majority shareholder to purchase the shares of the minority in specified situations, existed, these rights had to be clearly stated in the takeover bid circular,[110] as well as the offeror's intention to exercise his right of mandatory acquisition.

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[107] *Ibid*, paras. 7.19, 7.36(6); OSA ss. 89, 88a, 93, and 94.

[108] *Ibid*, para. 7.19, 7.36(6).

[109] *Ibid.*

[110] *Ibid*, paras. 7.21, 7.36(7); recommendation reflected in OSA s. 82(8).

5. Amendment of the Offer

Frequently, takeover bids were amended in the light of competing bids. This fact gave rise to the recommendation of the Merger Report to allow the offeree shareholders another 7 days to withdraw their shares after the amendment (except for the extension of the time for acceptance) was mailed to them.[111] The rationale behind this amendment was to provide for the offeree shareholders the best possible deal by facilitating competing bids. The amendment seems reasonable because otherwise the shares of the offerees would be locked up with the initial bidder for the whole term of the bid, and upon expiration of the initial 7 day withdrawal period the offeree shareholders did not even have an opportunity to respond to a competitive bid, if somebody decided to make one knowing that the shares have most probably been locked up with the initial bidder.

6. Conditional Offers

The recommendation to limit the conditions that can be attached to the offer was directed against so-called "market out" clauses.[112] Such clauses were sometimes used by offerors on the analogy with underwriting agreements and allowed them to back out of their commitment to take up and pay for the shares tendered if their subjective opinion had been changed and they no longer regarded the purchase of the offeree shares as a good business investment. On the first sight, this appeared to be a fair solution because once the offerees deposited their shares, and the withdrawal period expired, they were committed to sell the shares, and it looked only fair that the offeror should be equally committed to take up and pay for the deposited shares. However, the situation in the market may have objectively changed by the time the offeror could take up the deposited shares, or the directors of the offeree company may have disposed of its most attractive assets, or fundamentally changed its undertakings. Would it be fair to place all this risk

[111] *Ibid*, paras. 7.24, 7.36(9); s. 82(3).

[112] *Ibid*, paras. 7.25, 7.36(10).

only on the offeror? The legislators took into account the risk associated with possible changes in the standing of the target company caused by the actions of its directors, but failed to consider the risk allocation in the situation when adverse changes in the standing of the target company were caused neither by offerees, nor by the offeror. As a result, the only two conditions that the offeror was permitted by legislation to attach to his offer were (a) his right to withdraw on the failure of the offerees to tender the minimum number of shares of particular classes he was willing to accept, and (b) his right to withdraw where the action of the offeree board of directors subsequent to the date of the offer materially changed the undertakings, assets or capital of the offeree company.[113]

7. Extension of Statutory Restrictions

Two significant restrictive amendments were made on the basis of the respective recommendations outlined in the Merger Report. First, an offer for less than all of all classes of equity shares was made subject to the same statutory restrictions as were applicable to offers for less than all equity shares of a particular class. Thus, the offer for less than all of all classes of equity shares was to abide by the rules regarding time limits for deposition, taking up of and payment for the shares and *pro rata* take up of the deposited shares.

Second, in a takeover bid for all of the equity shares the offeror was obliged to commence accepting and paying for the shares tendered at the expiry of 35 days from the date of the offer or abandon his offer. This provision was aimed at preventing the offerees' shares from being tied up indefinitely. The Committee also considered an option to give the offerees the right to withdraw their shares upon expiration of 35 days, but instead recommended the provision stated above. While this provision might place an additional risk on the offeror requiring him to take a strategic decision at the end of the 35

[113]OSA s. 82(10).

day period either to go ahead or abandon his offer, it certainly did not make the offeree shareholders worse off, which was the sole concern of the legislators.

8. Communication Between Offeree Directors and Shareholders

The 1966 OSA had several issues which were drafted not very clearly, and one such issue concerned the possibility of communication between the offeree board of directors and shareholders short of a formal circular. The Merger Report proposed to resolve the uncertainty by clarifying that the only permitted communication between the offeree directors and shareholders short of a circular was a communication indicating that the offer was under study and a directors' circular is to follow.[114] The directors could also suggest that the shareholders did not deposit their shares before the receipt of the directors' circular. Such information might be useful to an unsophisticated shareholder who would rely on the directors' circular in making his investment decision.

The Committee did not insist on making the directors' circular mandatory, but whenever a particular director wanted to convey to the shareholders his personal opinion about the bid, the Committee recommended that he do it in the form of a circular conforming to certain requirements.[115] Such director should have disclosed his holdings and interest and provide any other information that would be required of the directors were a directors' circular sent[116]. While it is obviously to the advantage of the shareholders to receive a complete disclosure from their director, it might be likely that such extensive formal requirements would discourage any director from sending any information to the shareholders.

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[114]Merger Report, paras. 7.28, 7.36(12).

[115]Merger Report, paras. 7.29, 7.36(13).

[116]The resulting legislative wording can be found in OSA s. 87.

9. Power to Grant Exempting Orders

The Merger Report recommended that the right of the court to grant exempting orders pursuant to s. 80(b)(iv) should be vested in the OSC instead.[117] The amendment seemed expedient as the OSC was more qualified to review the merits of takeover bids and moreover, it could do it more rapidly.

C. The 1973 Recommendations

In 1973 the Select Committee on Company Law (Chairman - W. Hodgson) produced the Report on Mergers, Amalgamations and Certain Related Matters known as the Hodgson Report. The Hodgson Report contains a thorough analysis of contemporary takeover bid legislation and proposes significant amendments thereto, which are briefly discussed below.

1. Private Agreement Exemption

The biggest concern of the Select Committee was that a private agreement, i.e. an agreement with less than 15 shareholders, almost invariably involved the payment of a premium to the selling shareholders on terms not available to other shareholders. As a result, non-selling shareholders were in the position where control of the corporation in which they had invested changed without their will, and they were left with two options, either to remain as shareholders and accept the changed situation or to sell their shares on the market at a price which would undoubtedly be less than the price received by the controlling shareholders.

Imposition of the requirement of a general offer to all shareholders, or a follow-up offer to other shareholders, would definitely deprive the controlling shareholders of a

[117] Merger Report, paras. 7.17, 7.36(5); OSA ss. 81(b)(iv) and 90.

substantial part of the premium otherwise available to them. Without such a requirement, the position of the minority was prejudiced. Thus, the issue before the Select Committee was whose interests should be protected by law. A number of arguments were made in favour of the exemption and others made opposing it.[118] In the end, the members of the Select Committee did not come to a unanimous conclusion on the issue.

With considerable restrictions, the private agreement exemption is still preserved in the OSA, though it does not contain the word "private." The current status of this exemption will be discussed below.

2. Partial Bids

The Select Committee recommended to amend the provision that the offeror should not reduce the number of shares he was bound or willing to take up under the bid by the number of shares he might have purchased in the market by stipulating that any securities purchased by the offeror during the course of a takeover bid should be considered as having been acquired pursuant to the bid for the purpose of determining if the stated level of acceptance or specified percentage had been reached in a conditional bid.[119] The problem identified by the Select Committee was the different consideration paid to shareholders whose shares were purchased pursuant to the bid and in the market. The Select Committee raised this question, but did not propose any solution.

The Select Committee did not recommend to abolish partial bids for the reason that they were made to all shareholders, all shareholders could exercise judgement to accept or reject the bid as they saw fit, and they were all offered the same price.

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[118]Hodgson Report, Chapter 11.

[119]*Ibid*, Chapter 12.

3. Directors' Circular

The Select Committee saw no valid reason why the issue of a directors' circular should depend on whether the directors proposed to recommend acceptance or rejection of the bid.[120] The position of the Select Committee was that shareholders of the offeree company should be entitled to as much information as possible to enable them to form a reasoned judgement regarding acceptance or rejection of the bid. The directors' circular provides information which should be made available to the shareholders under all circumstances, thus, it should be mandatory in all cases. However, the directors should be free either to make a recommendation or refrain from making it because they are not investment advisors. A mandatory circular without a recommendation is sufficient. The amendment recommended by the Select Committee was that directors should disclose with respect to what amount of shares they intended to accept or reject the bid. Without specifying this amount, information might be misconstrued by a shareholder.

4. Conditions in a Takeover Bid

The Select Committee paid substantive attention to the issue whether it was permissible to attach any conditions to a takeover bid.[121] The Committee reasoned that the offeror was making more than an investment, he was acquiring control of the assets and business of the offeree company as a going concern. The offeror was primarily interested in the earnings and financial position of the offeree company. If, for instance, a substantial part of the offeree company were extensively damaged or destroyed or a valuable contract held by the offeree company was terminated between the making of the offer and prior to the take up of shares deposited thereunder, the offeror under the existing legislation would nevertheless be bound to complete the purchase even though the condition of the offeree company has substantially changed from that on which the offer

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[120] *Ibid*, Chapter 13.

[121] *Ibid*, Chapter 15.

was based. The issue is who should bear the risk of changes in the offeree company beyond the control of either offeror or offeree, which may affect the value of the offeree company.

If the bid is terminated, under contemporary legislative provisions, the offeree receives back his shares, and his position is not worse off than it would have been had the offer not been made. The risk to the offeror, however, is much greater. So, the offeror should be permitted to include reasonable conditions which should be clearly outlined in the legislation. For example, substantial damage, destruction or loss of major assets, a substantial change in the financial affairs of the offeree company since the date of its last published financial statements, approvals or permissions from regulatory bodies, where required, and an intervening act of a governmental authority which may have the effect of frustrating the bid. This is not, however, a suggestion that there should be the right of rescission after the takeover bid is closed.

5. Market Purchases During a Takeover Bid

The main concern of the Select Committee was over the price of the market purchases during the bid.[122] The Committee acknowledged that there might be cases when the offeror would pay more than the value of its bid in order to secure a block of shares. A respective recommendation for the legislation was to provide that, if the offeror purchased shares in the market at a price higher than the value of the bid on the date of purchase, the price offered by the bid should be increased to such price. This provision was dependent on the requirement that the offeror reported all purchases, including price, to either the OSC or the stock exchange. The Committee stated that the matter should be further studied.

[122] *Ibid*, Chapter 16.

6. Compulsory Acquisition and Compulsory Buy-Out

The Committee considered whether compulsory acquisition of 100 per cent of shares or compulsory buy-out provisions should be introduced in the Ontario legislation.[123] An offeror's right to acquire 100% of the shares of the offeree corporation of the class involved in the takeover bid where pursuant to the bid the offeror had acquired 90% of such shares already existed under federal corporate legislation and under some provincial jurisdictions, but has never existed in Ontario.

One of the justifications of compulsory acquisition was that takeover bids made for economic progress and a bid which received overwhelming support should be facilitated by law. Another justification was the desirability of preventing the "oppression of the majority by the minority" which resulted if a small minority could block a takeover bid, either in hope of exacting some extra payment by withholding approval or through lack of real interest. Even if there is no opposition or apathy, 100 per cent acceptance is seldom possible because of untraceable shareholders and executors and trustees who do not have authority, or are at the time not yet clothed with power, to accept the bid. Moreover, the objection in principle to the expropriation of property rights is tempered in modern conditions by the impersonality of much shareholding.

The Hodgson Report analyzed the difference between the two provisions. In a compulsory acquisition, the offeror may acquire on the terms of the bid; and in a compulsory buy-out, it may be on the terms of the bid or such other terms as may be agreed or as the court thinks fit.

As it will be further demonstrated, most of the recommendations given in the Hodgson Report were accepted by legislation and can be found in the current OSA.

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[123] *Ibid*, Chapter 17.

III. CURRENT TAKEOVER BID LEGISLATION

A. **Definition of a Takeover Bid**

Currently, a takeover bid is defined as "an offer to acquire outstanding voting or equity securities of a class made to any person or company who is in Ontario or to any security holder of the offfferee issuer whose last address as shown on the books of the offeree issuer is in Ontario, where the securities subject to the offer to acquire, together with the offeror's securities, constitute in the aggregate 20 per cent or more of the outstanding securities of that class of securities at the date of the offer to acquire."[124]

The definition of a takeover bid has undergone many changes. One of the issues that gave rise to many commentaries was whether a takeover bid was only an offer to purchase, or also an acceptance of an offer to sell. If a transaction is initiated solely by a prospective vendor and results in the purchaser's owning more than 20 per cent of the voting securities of a class, is it subject to takeover bid regulations? The current legislation answers in the affirmative and defines an offer to acquire as "an offer to purchase, or a solicitation of an offer to sell, securities; an acceptance of an offer to sell securities, whether or not such offer to sell has been solicited" or any combination therof, and a person accepting an offer to sell is deemed to be making an offer to acquire.[125] However, it might be argued whether such interpretation is consistent with the purpose of the takeover bid regulation, which is the protection of the offeree shareholders. If an offeree shareholder seeks himself a purchaser for his shares, without the latter's taking any actions towards the acquisition of control of the offeree company, is it fair to put on such purchaser the burden of complying with extensive regulatory requirements? Presumably, the decision of an offeree shareholder to sell his shares is a reasoned one,

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[124]Securities Act, R.S.O. 1990, c. S.5 (hereinafter, the "OSA"), s. 89(1).

[125]*Ibid.*

and by taking the initiative he demonstrates that he doesn't need the protection offered by legislation.

The present definition talks only about "outstanding voting or equity securities." S. 1(1) of the OSA defines a voting security as "any security other than a debt security of an issuer carrying a voting right either under all circumstances or under some circumstances that have occurred and are continuing." An equity security is defined in s. 89(1) as "any security of an issuer that carries a residual right to participate in the earnings of the issuer and, upon the liquidation or winding up of the issuer, in its assets." Pursuant to the definition, a non-voting preferred share or a debenture convertible into a common share would not be considered a voting security as long as such right has not been exercised. Neither rights and warrants that entitle the holder to acquire voting securities are considered to be voting securities. Only voting or equity securities being such at the moment of the offer to acquire fall within the legislative definition and are taken into account for the purposes of determining the 20 per cent ownership threshold of the purchaser.[126]

The previous definition of a takeover bid referred to the "voting securities of the company," while the current one refers only to "voting or equity securities of a class." This change makes a big difference. Previously, a bid was a takeover bid if an offeror owned (or would own as a result of the takeover bid) more than 20 per cent of all voting securities of an offeree. Such broad definition gave a potential for abuse, especially in companies which had more than one class of voting securities with different voting rights. It was possible for a purchaser to acquire a sufficient amount of voting securities of one class to give him effective control of the company without triggering the 20 per cent barrier. This legislative gap was used in two famous bids, the 1968 Gelco Enterprises bid

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[126]Note a different approach taken by the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, s. 194. For the purposes of determining whether a bid for the shares of a CBCA company is a takeover bid or not, the CBCA takes into account securities currently convertible into voting shares and currently exercisable options and rights to acquire a voting share or a security convertible into a voting shares.

and the 1969 Kirk Kerkorian's bid for the Metro-Goldwyn-Mayer shares,[127] where the bidders were able to obtain effective control without triggering the takeover provisions of the securities legislation. The present definition makes it more difficult for a bidder to avoid compliance with the regulating provisions. However, a potential for abuse still remains. Neither the OSA, nor the CBCA require that all voting shares of a company have equal rights unless they belong to the same class. A solution might be to calculate not the amount of voting shares (all or of one class) but the total amount of votes available in a company, and to require the bidder who has obtained more than 20 per cent of the votes, to comply with the takeover bid provisions, irrespective of the actual amount of shares that he owns.

Another issue much commented on concerns what securities are to be included in the offeror's securities for the purpose of establishing whether the 20 per cent threshold has been reached or not. Under s. 89(1) of the OSA, offeror's securities mean now "securities of an offeree issuer beneficially owned, or over which control or direction is exercised, on the date of an offer to acquire, by an offeror or any person or company acting jointly or in concert with the offeror." This definition was expanded compared to the 1978 OSA, which included in the definition of the offeror's securities only "voting securities in the offeree company directly or indirectly owned by the offeror or his associates."[128] Pursuant to the 1978 definition, any control or direction over voting securities in the offeree company by the offeror or his associates short of beneficial ownership did not appear to be relevant.[129] Under current definition, voting or equity securities held by the offeror in nominee or registered form and not beneficially owned or controlled by the offeror are not included in the calc''' ''ion, but any voting or equity securities of the offeree issuer controlled or directed by the offeror short of beneficial ownership are included in the calculation.

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[127]See Anisman, *supra* note 72, at p. 27.

[128]OSA s. 88(1)(i).

[129]See Alboini, V.P., *Ontario Securities Law* (Toronto: Richard de Boo, 1980), p. 660.

For the purposes of determining beneficial ownership, an offeror or joint actor is deemed to own beneficially securities, including unissued ones, which may be acquired within 60 days of the date of an offer to acquire pursuant to any right or obligation or which are convertible into such securities within the same time period (s. 90(1)).

The 1978 OSA used the notion of "associates" in defining the offeror's securities meaning "companies in which the offeror owns, directly or indirectly, more than 10% of the voting securities, any of the offeror's partners, any trust or estate in which the offeror has a substantial beneficial interest or to which the offeror serves as trustee or in a similar capacity, and any relative of the offeror including his spouse or any relative of his spouse who has the same home as the offeror."[130] The present OSA, instead of associates, uses a much broader notion of "any person or company acting jointly or in concert with the offeror." To include persons acting jointly or in concert with the offeror was one of the recommendations of the Practitioners Report.[131] In addition to associates, defined basically the same as in the previous legislation,[132] the definition also includes every person or company who, as a result of any agreement, commitment or understanding, whether formal or informal, with the offeror or with any other person or company acting jointly or in concert with the offeror, acquires or offers to acquire securities of the issuer of the same class as those subject to the offer to acquire, or intends to exercise jointly or in concert with the offeror any voting rights attaching to any securities of the offeree issuer. The definition ensures that the securities owned by associates of or any persons or companies acting jointly or in concert with the offeror are included in the calculation of the joint bidder's securities.

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[130]The 1978 OSA, s. 1(1)2.

[131]Practitioners Report, p. 8.

[132]For definition, see s. 1(1) of the OSA.

B. Exemptions from Takeover Bid Regulations

The current OSA exempts six kinds of bids from compliance with takeover bid regulations. However, even if the offeror complies with all formal requirements of a particular exemption, it does not automatically mean that he will be able to use it. The main thing to be considered here is whether the use of an exemption is consistent with the objectives of the OSA or runs contrary to it. In the view of the OSC, exemptions should generally be available in the circumstances in which it is reasonable to expect that the purpose of takeover bid regulations will be carried out. Where the strict terms of an exemption are met and the policy objectives are fully carried out, the OSC has no basis for intervening in a bid. But where the policy objectives are not carried out, then the OSC may intervene in a bid even if the strict terms of the exemption have been met.[133] Presently available exemptions are discussed below.

1. Stock Exchange Exemption

A bid made through the facilities of a stock exchange recognized by the OSC for the purposes of clause 93(1)(a) is exempt from sections 95 to 100 of the OSA. At present, three stock exchanges are recognized by the OSC for the purposes of this clause: the Toronto Stock Exchange, the Montreal Exchange, and the Vancouver Stock Exchange.[134] The purpose of this exemption was to permit free market forces to operate with minimal regulatory intervention.[135] Originally, no extensive disclosure of stock exchange bids was required. The policy regarding the disclosure of stock exchange bids was revised following the Abitibi-Price takeover in 1974.[136] Presently, if a bid is made in

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[133]*E.g., Re Mithras Management Ltd.*, April 27, 1990 O.S.C.B. 1600.

[134]Recognition Order 21-901 - Stock Exchange Recognition Order. February 25, 1997: (1997), 20 O.S.C.B. 1034, as amended August 29, 2000: (2000), 23 O.S.C.B. 6079.

[135]Alboini, V.P., *Securities Law and Practice*, 2nd ed. (Toronto: Carswell, 1984), §20.6.1.

[136]See Alboini, *supra* note 129, at pp. 664-665.

reliance on this exemption, it should be made in accordance with the by-laws, regulations and policies of the particular exchange.[137] With regard to the Toronto Stock Exchange (the "TSE"), such regulations can be found in Part XXIII of the TSE General By-Law, the principal provisions of which are discussed below.

In the TSE General By-Law a takeover bid is defined as "an offer to acquire such number of the listed voting or listed equity securities of an offeree issuer that will in the aggregate constitute (i) 20% or more of the outstanding securities of that class, together with the offeror's securities,[138] or (ii) in the case of an offeree issuer that is subject to the *Canada Business Corporations Act*, 10% or more of the outstanding shares of a class of listed voting shares, together with (A) shares already beneficially owned or controlled, directly or indirectly by the offeror or an affiliate or associate of the offeror, and (B) securities held by such persons or companies that are currently convertible into such shares; and (C) currently exercisable rights and options to acquire such shares or to acquire securities that are convertible into such shares, on the date of the offer to acquire."[139]

Two types of acquisitions may be made pursuant to Part XXIII of the TSE General By-Law, a normal course purchase or a stock exchange takeover bid. The normal course purchase exemption allows an offeror, together with any persons or companies acting jointly or in concert with him, to purchase up to 5% of securities of a class of securities of a listed offeree issuer in 12 months. Theoretically, a bidder may first acquire 20% minus one share of the offeree issuer's shares without triggering the takeover bid provisions of the OSA, and then acquire 5% more through a stock exchange in reliance on the normal course purchase exemption. Thus, it is possible to acquire up to

[137]OSA s. 93(4).

[138]Offeror's securities, voting securities, equity securities, offer to acquire and other terms used in the OSA have the same meaning as in the OSA. TSE General By-Law, s. 23.01(2).

[139]*Ibid*, s. 23.01(1)(u).

25% of shares. However, other provisions then come into play, namely, the insider trading provisions. Any person or company who beneficially owns, directly or indirectly, more than 10% of the voting rights attached to all voting securities of a reporting issuer is considered to be an insider[140] and should comply with reporting requirements of s. 107 of the OSA. The principal requirement for an insider is that it should report its direct or indirect beneficial ownership of securities of a reporting issuer within 10 days after the end of the month in which it becomes an insider, and also report any changes from the previous report within the same period.

A stock exchange takeover bid is a takeover bid, other than a normal course purchase, made through the facilities of the TSE.[141] It may be more preferable than a regular circular bid under the OSA if the bidder already holds a substantial block of shares of the offeree company. If, however, the bidder has only minor holdings in the offeree issuer, or no holdings at all, he may prefer to go with a circular bid for the following reasons: a circular bid may be conditioned upon a certain number of shares being deposited, and if the bidder does not obtain the desired amount of shares, he may withdraw the bid. In a stock exchange bid it is not possible. The bidder may specify the maximum number of shares that he is willing to acquire, but if less shares are deposited, he is obliged to take up all the deposited shares, sometimes without achieving the desired degree of control. The only circumstances that permit the bidder to withdraw his bid are either under s. 23.10(b)[142] or under s. 23.03(3)(a)(ii).[143] If more shares are tendered than the offeror is willing to take up, such shares should be taken up proportionately.[144]

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[140]OSA s. 1(1).

[141]TSE General By-Law, s. 23.01(1)(s).

[142]If a competing stock exchange bid is announced, and the offeror's bid is neither the ranking bid nor the last bid, it may be withdrawn within one clear trading day of the announcement of the last bid. *Ibid*, s. 23.10(b).

[143]If an action by any other person than the offeror effects an adverse material change in the affairs of the offeree issuer. *Ibid.*

[144]*Ibid.*, s. 23.07(2).

An offeror is also required to file a notice with the TSE and is not allowed to proceed with the bid until the notice has been accepted by the TSE.[145] The contents of the notice are not substantially different from a circular.[146] After the notice has been accepted by the TSE, the offeree is required to send copies thereof to each shareholder and to issue a press release with the details of the bid.[147] Note that in the case of a normal course purchase an offeror is not subject to any notice requirements.[148]

An offeror is not given much freedom to amend his bid. He can only increase the price per share offered or the number of shares sought or agree to pay an amount in respect of the seller's commission or a combination thereof.[149] All amendments should be filed with the TSE in the form of a notice acceptable to the TSE.

In the case of a stock exchange takeover bid, the directors of the target company should issue a press release, within seven trading days after the offeror's notice has been accepted by the TSE, recommending acceptance or rejection of the offer, or indicating that the directors are not making any recommendations, with the reasons for each statement.[150] It is the last choice that makes a directors' circular under a stock exchange takeover bid different from a directors' circular under a circular bid. In a circular bid, the directors are also entitled to recommend acceptance or rejection of the bid, but they cannot choose to remain silent in the circular about their evaluation of the bid. In a stock

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[145] *Ibid.*, s. 23.03(4).

[146] *Ibid.*, s. 23.04(1).

[147] *Ibid.*, s. 23.03(5).

[148] *Ibid.*, s.23.13.

[149] *Ibid.*, s. 23.08(1).

[150] *Ibid.*, s. 23.09(1).

exchange takeover bid, they can. A copy of the press release should be filed with the TSE prior to its release.[151]

Normally, an offeror making a stock exchange takeover bid and any person or company acting jointly or in concert with him are not allowed to purchase shares that are the subject of the bid through the facilities of the TSE. However, the TSE may grant them an exemption under s. 23.17, and in this case the offeror and those acting in concert with him may purchase not more than 5 per cent of such securities within the preceding 90 days through the facilities of a stock exchange or otherwise, and they also should comply with other requirements of s. 23.11.

2. *De Minimis* Exemption

The exemption in s. 93(1)(b), usually referred to as *de minimis* exemption, allows a security holder to increase his holdings by up to 5% without being subject to takeover bid regulation requirements. In order to qualify for this exemption, the purchaser should comply with two important restrictions.

First, the offeror, together with any person acting jointly or in concert with him, may not purchase more than 5% of the outstanding securities of a class of securities of the issuer in 12 consecutive months in reliance upon this exemption. A purchase of securities under a circular bid or under another exemption clause is not included in the calculation of 5% under the *de minimis* rule. Second, if there is a published market for the securities being acquired the consideration paid for such shares may not exceed the market price at the date of acquisition plus reasonable brokerage fees or commissions actually paid. For the purposes of this clause, the market price is determined as the price of the last board lot

[151] *Ibid.*, s. 23.09(2).

of target shares, before the acquisition by the purchaser relying on the exemption in s. 93(1)(b), paid by a person who is not a joint actor of the purchaser.[152]

The two restrictions noted above may be said to substantially narrow the scope of application of the *de minimis* exemption. Nevertheless, this exemption is used, and primarily in three circumstances.[153] First, a holder of, for example, 17% of outstanding shares of a class of equity or voting shares of the issuer wishes to acquire additional 5% in the over-the-counter market. The purchase is made through a broker, thus, a bid is considered to be an offer to security holders generally, and the private agreement exemption (it will be discussed next) is not available, even if the shares are purchased from less than five shareholders. In this case, the purchaser may rely on the *de minimis* exemption. Second, this exemption allows the same holder to purchase 5% of shares from more than five shareholders. Third, the same offeror may decide to purchase 5% of shares of a corporation through a stock exchange not recognized by the OSC for the purposes of the stock exchange exemption in s.93(1)(a) (assuming that such a bid is a takeover bid under the OSA).

3. Private Agreement Exemption

Though the current wording of the exemption in s. 93(1)(c) does not contain the word "private," it is still referred to as the "private agreement exemption" because the offer cannot be made to security holders generally.[154] It is not quite clear whether the

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[152]Securities Act Regulation 183(5).

[153]For detailed analysis, see Alboini, *supra* note 135, §20.6.5.

[154]It is interesting to note how this exemption developed. It was initially recommended by the Kimber Committee on the grounds that the law should not impose restrictions on the sale by private agreement of a controlling block of shares (Kimber Report, para. 3.12), but it was never intended to allow offers to be made to a great number of shareholders. The rationale was rather to exempt purchase and sale agreements where the sellers were in an equal bargaining position with the purchaser, were not under pressure and were in the position to obtain the necessary information to take a reasoned decision whether to sale their shares or not. See also Anisman, *supra* note 72, pp. 37-44, and Prentice, *supra* note 73, pp. 332-333. Following the recommendation of the Merger Report (paras. 7.10, 7.36(1)), the number of private agreements not amounting to the general offer was restricted to fifteen. Later, out of the concern that

purchaser is prohibited from soliciting vendors generally or from making a specific offer to shareholders generally. The only clarification available can be found in Policy No. 9.3 which states that this exemption is not available to an offeror while that offeror has a circular bid outstanding.[155]

Two important restrictions are imposed on the offeror who wishes to rely on the private agreement exemption. First, the offeror cannot make purchases from more than five persons or companies in the aggregate, irrespective of the residence of the holders, and cannot make the bid to security holders of that class of securities generally. Second, the question arises as to who are considered the holders for the purposes of clause 93(1)(c)(i). This issue is partly dealt with in s. 93(2) which requires the offeror to make a reasonable enquiry whether the seller from whom he is to purchase the securities acts as nominee, agent, trustee, executor or other legal representative of another person or company. If so, each of the beneficiaries should be included in the determination of the number of sellers. The difficulty here arises with interpretation of "other legal representative." Should it be interpreted consistently with the previous wording and, consequently, restricted to instances where legal representatives act in relation to trusts and estates? If so, then a legal representative acting otherwise (for example, as a broker or a financial institute) should be considered the security holder for the purposes of the exemption. A practical interpretation might be different, and a term "trustee" might include a nominee owner acting on behalf of beneficiaries. However, if a registered holder of securities with several beneficial owners gives a power of attorney to another person to enter into a purchase agreement for the shares, it is not clear who should be considered to be the security holder, and what should be the extent of the reasonable enquiry of the purchaser.

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frequently controlling interests in companies were sold at a premium which was not available to minority shareholders, an obligation to make a follow-up offer was imposed on the offeror if more than 15% premium was paid for the acquisition of more than 20% of voting securities of a public company. See Alboini, *supra* note 128, pp. 683-688.

[155] O.S.C. Policy No. 9.3, section A.

There are two exceptions to the rule. The first exception concerns an *inter vivos* trust. If such trust has been established by a single settlor, the trust shall be counted as one security holder. The second exception permits to count as a single security holder an estate that has not vested in all persons beneficially entitled thereto.

The purchaser has an obligation to make one more reasonable enquiry and to make sure that the sellers did not acquire the securities in order for the purchaser to make use of the exemption.[156] If the offeror knows or ought to know after a reasonable inquiry that that was the case, each of the original sellers from whom the securities were purchased should be included in the determination of the number of persons for the purposes of the exemption.

The second restriction imposed on the purchaser under the private agreement exemption concerns the purchase price of the securities. The offeror is not allowed to pay consideration for any of the securities, including brokerage fees or commissions, in excess of 115% of the market price of the securities of that class at the date of the bid determined in accordance with the Regulations.[157] When there is a published market for the securities, the market price is determined as an amount equal to the simple average of the closing price of securities of that class for each of the business days on which there was a closing price falling not more than twenty business days before that date.[158] When the published market does not provide a closing price, but only the highest and lowest prices of securities traded on a particular day, the market price at any date is determined as an amount equal to the average of the simple averages of the highest and lowest prices for each business day on which there were highest and lowest prices falling not more than twenty business days before that date.[159] The Regulations also provide detailed

[156]OSA s. 93(2)(b).

[157]OSA s. 93(1)(c)(iii).

[158]Regulation 183(1).

[159]Regulation 183(2).

instructions on calculation of the market price in cases where there is more than one published market for a security, or there has been trading in securities in a published market for fewer than ten of the twenty business days preceding the date in question.[160]

4. Private Issuer Exemption

An offeror may also use the exemption in s. 93(1)(d) available when the target company is a private issuer. To qualify for this exemption, the target company should meet the following requirements: (1) it is not a reporting issuer; (2) there is no published market for the securities which are the subject of the bid; and (3) there are not more than fifty holders of securities of that class. For the purpose of determining the number of security holders, employees and former employees of the offeree issuer or its affiliates who became the security holders during their employment, are not counted.

Sometimes, companies' use of this exemption is challenged by the OSC under s. 127(1)3 if the manner in which it is used clearly violates the policy objectives of the whole takeover regulation. For example, in *Re Mithras Management Ltd.*,[161] promoters made a takeover bid for limited partnership units using the private issuer exemption without disclosing any information to the unit holders. Consequently, they had not informed the unit holders that the payments were contingent on the financial performance of a group of companies related to the promoters. Later, the promoters failed to make the required installment payments. The OSC noted that the underlying purpose of the securities regulation was the protection of the integrity of the capital markets and in particular the protection of investors who were solicited in the course of a takeover bid. The OSC could not enforce payment to investors, but it was concerned about the lack of adequate disclosure to the investors of basic information that clearly would have affected their decision whether or not to accept the bid. The OSC was concerned that the investors

[160]Regulations 183(3)-(5).

[161]1990 O.S.C.B. 1600.

were not told "that they might have to wait "until the cows come home" to be paid what they had every reason to expect, based on what they were told, would be paid as and when it fell due."[162] In this case, the OSC used its power to order that the exemptions in s. 93 should not apply to the respondents until such time as the OSC would otherwise order.

In *Re Tesco Corporation*,[163] the takeover bid for the units of the joint venture was exempt by the OSC under s. 104(2)(c) from the takeover bid requirements of the OSA which found that in this case it was possible to use the exemption of s. 93(1)(d). The joint venture had 58 unitholders, 9 of whom were the employees of the operator of the joint venture or Tesco. Formally, the exemption was not available, but as the joint venture was not an independent legal entity capable of entering into employment contracts, the OSC found it possible not to count these 9 employees for the purposes of the 50 persons maximum in s. 93(1)(d) and to grant the respective exemption.

5. De Minimis Takeover Bids Originating in Recognized Jurisdictions

This exemption is available under four conditions: (1) there are less than 50 Ontario resident holders of securities subject to the takeover bid; (2) such holders hold less than 2% of such securities; (3) the bid is made in compliance with the laws of a recognized jurisdiction; and (4) Ontario resident holders should receive all material relating to the takeover bid sent by the offeror to the holders of the target shares.[164]

The recognition of Canadian provinces and territories depends on whether a respective province or territory has adopted its own takeover bid legislation and whether

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[162] *Ibid*, at p. 1619.

[163] 1998 O.S.C.B. 167.

[164] OSA s. 93(1)(e).

such regulations are substantially consistent with those in Ontario. For the purposes of this clause, the following Canadian jurisdictions are recognized by the OSC as of March 1, 1997: the provinces of British Columbia, Alberta, Saskatchewan, Manitoba, Quebec, Nova Scotia and Newfoundland.[165] The recognition of jurisdictions outside Canada depends upon "there being reasonable rules and procedures in place in the jurisdiction, an essential element of which is a requirement to send to shareholders in Ontario a disclosure document approximating the quality of the document that would otherwise be required to be filed and sent to shareholders."[166] Thus, for the purposes of this clause the OSC recognizes the United Kingdom if the bids are in compliance with the rules of The City Code on Take-overs and Mergers and are not exempt therefrom, and the United States if the bids comply with the requirements of the Securities and Exchange Commission and are not exempt therefrom. The introduction of this exemption reduces the need for exempting orders of the OSC earlier generally made on the condition that all material sent to shareholders of the target corporation resident in the United States or the U.K. be sent to those shareholders of the target corporation resident in Ontario and filed with the OSC.

Sometimes, however, exemptions are granted to takeover bids made in accordance with non-recognized jurisdictions. For instance, in *Re Skandia Insurance AB*,[167] where there was one shareholder resident in Ontario holding less than 1% of the target shares, the share exchange takeover bid made by Swedish companies was exempt on the basis that the prospectus provided a level of disclosure that was substantially similar to that provided in Form 32.

[165]Recognition Order 62-904 - Recognition of Certain Jurisdictions. February 25, 1997 (1997), 20 O.S.C.B. 1035.

[166]O.S.C. Policy 3.1, section L.

[167]1989 O.S.C.B. 2650.

6. Exemption by Regulations

A takeover bid may also be exempt from the requirements of ss. 95 - 100 of the OSA by regulations. Regulation 184 establishes three conditions for exempt takeover bids: (1) there is no published market for the securities which are the subject of the bid; (2) purchases are made from not more than five persons or companies in the aggregate, including those outside of Ontario; and (3) the bid is not made generally to the holders of the above securities. This exemption may be seen as a qualification on the private agreement exemption which imposes a 15% premium limit.

C. Substantive Legislative Requirements to Takeover Bids

1. Acquisitions and Sales During, Before and After Takeover Bid

S. 94 of the OSA regulates what acquisitions an offeror may or may not make during a circular or a stock exchange takeover bid, when there is integration with pre-bid private transactions, imposes restrictions on post-bid acquisitions and establishes certain exceptions from the above requirements. For the purposes of s. 94, an offeror is defined as any of the following: a person or company making a regular circular bid; a offeror making a bid through the facilities of a stock exchange; joint actors of any circular or stock exchange offeror; a controlling person of a circular or stock exchange bidder; an affiliate of such controlling person; or an associate of such controlling person acting jointly or in concert with him. If an associate is not acting jointly or in concert with the controlling person referred to above, it is not included in the definition.[168]

[168]Securities Act Regulation 185(3).

a. *Acquisitions During Takeover Bid*

While a circular or a stock exchange takeover bid is outstanding, i.e. from the day of the announcement of the offeror's intention to make the bid and until the bid expires, the offeror is prohibited from acquiring, making an agreement, commitment or understanding to acquire beneficial ownership of any securities of the class subject to the bid otherwise than pursuant to the bid.[169] According to s. 89(2)(b), a bid is considered to have expired either at the end of the deposit period or at the date at which the offeror is required to take up or reject the target securities, whichever date is later. Securities beneficial ownership to which the offeror may acquire within sixty days after a given date are also included in the above prohibition.[170]

While the bid is outstanding, the offeror cannot make purchases of the target securities in reliance on any of the exemptions provided by the OSA. There is only one exception which permits the offeror to purchase securities of the class subject to the bid and any securities convertible into the securities of the class subject to the bid during the takeover bid. A number of conditions must be satisfied before the offeror can make purchases in reliance on this exception. These conditions include the following:

(i) purchases may be made only through the facilities of a stock exchange recognized by the OSC for the purpose of s. 93(1)(a);

(ii) purchases may be made during the period starting not earlier than the third business day following the date of the bid and until the bid expires (the three days delay ensures that the market has time to react to the takeover bid, and there are less chances that shareholders who are selling their shares through a stock exchange

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[169] OSA s. 94(2).

[170] OSA s. 90(1).

will be at a disadvantage as compared to those tendering their shares under the bid and will receive a lower price);

(iii) the offeror should clearly state his intention to make such purchases in the takeover bid circular;

(iv) under the rule, the offeror is allowed to purchase maximum 5% of the outstanding shares of the class subject to the bid; and

(v) after the close of business of the stock exchange the offeror should issue and file a news release disclosing the information prescribed by Regulation 188, and he is obliged to do this each day he purchases shares under this subsection.

b. *Integration with Pre-Bid Private Transactions*

It is the policy of the takeover bid regulation that all shareholders should be treated equally. In addition to requiring equal consideration to be paid to all tendering shareholders under the bid (as will be discussed later), the OSC is also concerned about so-called "linked" transactions. The OSC considers a purchase of shares under a private agreement prior to the takeover bid, where the bid is for securities of the same class, to be linked together. The integration rule applies if the terms of such prior transaction were not generally available to all security holders.[171] In this case, the OSA requires any formal takeover bid made within the period of ninety days after a private purchase agreement to comply with the following two provisions:

(i) the consideration offered by the offeror under the subsequent circular or stock exchange bid should be at least equal to the highest consideration paid for securities of the same class in a transaction prior to the takeover bid. If the consideration offered in a prior private transaction was not cash, or was not wholly cash,

[171]Integration is not necessary in the case of purchases of target shares pursuant to a distribution under clause (a) or (b) of the definition of "distribution" in s. 1(1) (Regulation 186).

the consideration offered under the bid should be equal to the cash equivalent of that highest consideration. The offeror may also choose to offer a higher consideration; and

(ii) under the subsequent circular or stock exchange bid, the offeror must offer to acquire the percentage of shares at least equivalent to the highest percentage of shares acquired in a prior private transaction.

The integration rule was obviously designed for the advantage of offeree shareholders who did not participate in the private purchase transaction. Its objective is to ensure that all offeree shareholders receive the price for their shares at least equal to the price received by some shareholders in a private transaction, and that all holders of the shares of the same class receive an opportunity to sell at least the same percentage of their shares as the percentage of shares sold by some shareholders in a prior private transaction. However, the rule does not work the other way round and does not require the offeror to pay an increased consideration to the vendor in a private transaction if the consideration offered under the subsequent bid is higher.

Purchases under a prior private agreement include purchases through a recognized stock exchange, but do not include true market trades, i.e. normal market purchases in a published market, pursuant to s. 94(7). The rationale for this exception is that in a published market trade occurs at a market price which is available to every shareholder willing to sell his shares. Any joint actors or affected parties of the offeror are also excluded from integrating their prior true market purchases with the subsequent takeover bid. The exception is not without conditions. The services of a broker acting for the purchaser or seller must be limited to those customary for a broker. The remuneration received by each broker must be limited to "reasonable fees or commissions."[172] Neither

[172]It may, however, be difficult for the purchaser to determine whether or not the seller's broker was performing services beyond the "customary dealer's function" or whether the seller's broker was receiving "more than reasonable fees or commissions." See Alboini, *supra* note 135, §20.8.5.

the purchaser nor the seller nor any person acting for them may solicit or arrange for the solicitation of offers to sell or buy.

As for trades in securities of an issuer that have not been previously issued, or trades by or on behalf of an issuer in previously issued securities of that issuer that have been redeemed or purchased by or donated to that issuer, according to Regulation 186, they are not counted for the purpose of s. 94(5).

c. *Post-Bid Acquisition Restrictions*

The bidder by a circular or stock exchange takeover bid, including any its joint actors or affected parties, is prohibited from purchasing securities which were the subject of the bid during twenty days upon the bid's expiration if the terms of such post-bid transaction are not generally available to all other security holders. According to s. 89(2)(b), a bid is considered to have expired either at the end of the deposit period or at the date at which the offeror is required to take up or reject the target securities, whichever date is later.

Reading ss. 94(3) and (6) together, the combined effect is the following: an offeror (including all its joint actors and affected parties) under a circular or stock exchange takeover bid is prohibited from making any purchases of the securities which are the subject of the bid for the first two business days following the announcement of the bid, then there is a period of permitted purchases beginning on the third business day after the announcement of the bid and ending on the expiry of the bid, and then again purchases are prohibited for twenty more business days.

Note that there is an exception to the post-bid acquisition rule, and that is true market purchases. The contents of the exception were discussed in the previous section.

d. *Sales During Bid*

The rule is that while the bid is outstanding, i.e. from the date the bid is announced and until the date it expires, the offeror is prohibited from selling the securities which are the subject of the bid and from entering into any agreements, commitments or understandings to sell the said securities. As all rules, this one is also subject to exceptions. In this case, there are two. The first exception refers more to an issuer bid and allows the issue of securities by an issuer pursuant to a stock dividend plan, dividend reinvestment plan, employees' stock purchase plan or other similar plan. The second permits the offeror to enter into arrangements, commitments or understandings to sell securities that may be taken up during the takeover bid on two conditions: (i) the securities may be sold only after the expiry of the bid, and (ii) the intention of the offeror to sell should be explicitly disclosed in the takeover bid circular. These provisions apply to stock exchange bids as well.

2. Delivery of Bid

Generally, the bid must be made to all holders of securities of the class subject to the bid who are resident in Ontario and must be delivered, in addition to such holders, also to the holders of securities convertible to securities of the class that is subject to the bid.[173]

It may seem that the offeror is not required to deliver the bid to offerees resident in other jurisdictions. However, this is not so. The OSC was concerned that non-delivery of the takeover bid circular to security holders in jurisdictions other than Ontario might be prejudicial to their interests and not consistent with the principle of equal treatment of all security holders of a target company. This concern expressed itself in National Policy 62-201.[174] With a view to further the interests of all security holders in their respective

[173]OSA s. 95.1.

[174]Formerly, National Policy No. 37; rescinded and replaced by NP 62-201; (1997) 20 O.S.C.B. 3523.

jurisdictions and of a national capital market, the OSC may issue a cease trade order in respect of the bid if the offeror fails to make the bid to security holders in all jurisdictions where such security holders are resident. Before issuing a cease trade order, the OSC generally provides the offeror with an opportunity to address the situation.

Taking into consideration the *de minimis* test in s. 93(1)(e), the offeror is usually exempted from delivering the bid to security holders in a jurisdiction if in such jurisdiction there are less than fifty holders of securities of the class subject to the bid and they hold in the aggregate less than two per cent of the outstanding securities of that class.

3. Deposit Rules

The current OSA preserves the requirement of the original takeover bid legislation regarding the minimum deposit period. Pursuant to s. 95.2, the offeror cannot establish a period for deposit of shares under the announced takeover bid of less than 21 days. Twenty one days are regarded by current legislation as sufficient for the offeree shareholders to assess all available information about the bid and take a reasoned decision whether to tender their shares or not, and also for competing bids to emerge.

The offeror has a right to establish a longer deposit period, upon his discretion. However, there is one case when the offeror is obliged to extend the deposit period, and that is when there is a variation in the terms of the bid. In such case, the offeree shareholders must be given additional ten days after the delivery of the notice of variation to deposit their shares.[175]

[175]OSA s. 98(5).

4. Withdrawal Rules

Once shareholders have deposited their shares under a takeover bid, it does not mean that they have to go on with the bid. They may change their opinion about the price offered or they may choose to respond to a competing bid. In this case, they are given three periods of time during which they may withdraw the deposited shares:

(i) at any time from the date of the bid until the expiration of twenty-one days;

(ii) in case of a notice of change or variation under s. 98, for ten days after the date of such notice; and

(iii) if the offeror has not taken up and paid for the securities, the offerees have a right to withdraw them after forty-five days from the date of the bid.[176]

The 21-day withdrawal period is designed to provide target shareholders with sufficient time to digest the impact of the offer itself, to assess market trading activity and the possibility of competing offers and to react not only to any competing offers actually made but also to the information and any recommendation contained in the directors' circular which must be communicated to the offeree holders within 10 days of the making of the bid.[177]

A shareholder may withdraw his shares by delivering a written or printed copy of the notice of withdrawal to the depositary designated under the bid.[178] Only the actual receipt of the copy of the withdrawal notice makes the notice effective. The legislation

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[176] The legislation does not establish a maximum period during which a takeover bid should remain open. Thus, allowing the offeree shareholders to withdraw their shares after forty-five days from the date of the bid serves as a limit on a reasonable bid period.

[177] Practitioners Report, p. 22.

[178] OSA s. 95.6.

does not specify the period of time during which the shares should be returned to the shareholder who has deposited them. Presumably, this should happen simultaneously with the actual receipt of the withdrawal notice.

In three cases the withdrawal rules described above do not apply: (1) if by the date of the notice of change or variation the offeror has already taken up the deposited securities, the transaction is not reversed; (2) if a variation in the terms of the all cash bid consists solely of the waiver of a condition; and (3) if a variation in the terms of the bid consists solely of the price increase and the deposit period after the date of notice of variation is not longer than 10 days, the shareholders do not have a right to withdraw their shares.[179] The legislation finds other means to protect the shareholders in this case and to make sure that the increased price is paid to all offeree shareholders irrespective of the time when the shares were deposited or when they were taken up.[180]

5. Take-Up Rules

As the offeree shareholders have twenty one days to withdraw the deposited shares, the offeror is accordingly prohibited from taking up any deposited shares until the expiration of twenty one days from the date of the bid,[181] whether the bid is for all or for less than all shares of a class. Where the bid is a partial one and more shares are

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[179] The provision originates in the recommendations of the Merger Report, though the latter did not distinguish between different types of variation, except for the extension of the time for acceptance, and recommended that any change in the offer should entitle the offerees for additional seven days from the time the amendment is mailed to them to withdraw their shares. See Merger Report, para. 7.24.

[180] The current approach of the legislation seems reasonable. Once the law guarantees the increased price to all tendering shareholders, there is no need for them to withdraw their shares, unless there is another variation in the bid terms, besides price increase. Anisman also argues that only the price increase is not a good reason to allow the shareholders to withdraw. Where the price is increased because of a competing offer or to induce more deposits, the offerees who accepted the bid did so, assuming the bid complied with the statute, after an opportunity to assess the information thought necessary by the legislature. The purpose of the legislation should not be altered to ensure that an offeree receives the highest possible price for his shares regardless of a previous considered decision to tender. Anisman, *supra* note 72, p. 92.

[181] OSA s. 95.3.

deposited than the offeror is bound or willing to purchase, the offeror must take up securities proportionately to the number of securities deposited by each participating security holder.[182]

The 21-day period is considered to be an important protection for target shareholders. By prohibiting taking up of the deposited securities by the offeror earlier, the legislator guarantees that all target shareholders who decide to respond to the bid will be treated equally. Moreover, before the offeror knows how many shares have been deposited and can be taken up, he cannot know how to prorate them. Thus, both equal treatment of the offerees and time for them to consider the offer are ensured.[183] The *pro rata* requirement was initially imposed upon the recommendation of the Kimber Committee[184] to enable all offeree shareholders who want to participate in the bid to have an equal proportion of their shares taken up and to prevent the offeree insiders from gaining advantage of an early deposit and to prevent treatment of the offeree shareholders on a first come, first served basis.[185]

Generally, securities deposited under the bid must be taken up and paid for by the offeror not later than ten days after the expiry of the bid.[186] The offeror is allowed to

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[182]OSA s. 95.7. The OSA does not use the term "partial bid." Most of the rules of the current takeover regulations refer to all bids. The only article where there is a reference to what was formerly called "partial bid" is s. 95.7 which speaks about bids "for less than all of the class of securities subject to the bid."

[183]See Anisman, *supra* note 72, pp. 71-74.

[184]Kimber Report, para.3.17.

[185]Anisman argues that the *pro rata* requirement may have not only beneficial effects. After a *pro rata* take up, offerees with small shareholdings may be left with a few shares which they do not want to keep but which may be difficult to sell. Sometimes, takeover bids were made with special provision for complete acceptance by holders of less than a fixed number of shares, but this practice does not seem quite fair. Anisman offers a compromise which might be reasonable for shareholders left with "tag ends": to permit the offeror to round off the acceptances of holders of less than a number of shares specified in the offer to the nearest board lot, which, in his view, might help small shareholders to dispose of their lots. See Anisman, *supra* note 72, p. 74.

[186]OSA s. 95.9.

make its obligation to take up the deposited securities conditional upon certain terms established in the bid. Now, the take up and payment obligation of the offeror may be subject to any condition, except for having adequate financing.[187] When the bid conditions have not been met or waived, the offeror is not restricted from extending the bid. However, if such conditions have been complied with and not waived by the offeror, the latter is prohibited from extending the bid, unless he first takes up and pays for all securities that have been deposited and not withdrawn by offerees.[188] After the bid conditions have been complied with (or waived by the offeror), the offeror is required to issue a respective news release disclosing the approximate number of securities deposited and the approximate number of securities that he is planning to take up.[189]

If the offeror makes his bid conditional upon the minimum number of shares deposited, and at the same time he purchases up to 5% of securities subject to the bid through a recognized stock exchange and in accordance with s. 94(3), the securities purchased in the market shall be counted for the purpose of determining whether the minimum number of securities condition has been met, but such otherwise purchased shares shall not reduce the number of securities that the offeror is bound to take up under the bid.[190] The rationale of this rule is to protect the target shareholders who deposit their

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[187]To eliminate all restrictions on conditions that can be attached to a takeover bid was one of the recommendations of the Practitioners Report. On pp. 23-24 it was noted there that while the absence of any restrictions on the use of conditions "may lead to an offeror attaching specific or unique conditions to its takeover 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." See Alboini, *supra* note 135, §20.1.11.

[188]OSA s. 95.12. The OSC seems to be flexible in changing the restrictions in this section. For example, in *Re Russell Holdings Limited*, February 5, 1988 O.S.C.B. 543, competing bidders were permitted by the OSC to extend their offers without taking up and paying for shares as otherwise required by s. 95.12, conditional upon depositing shareholders being entitled to withdraw their shares from either offer before expiration. In *Re Spruce Falls Acquisition Corp., Tembec Inc. and Tembec Acquisition Corp.*, April 4, 1997 O.S.C.B. 1704, the bidder was also permitted to extend his offer without paying for shares already deposited on the condition that he takes up all the shares deposited under the offer before making the extended offer and pays for all the shares deposited under the original offer not more than three days after taking up the shares. See Alboini, *supra* note 135, §20.9.8.

[189]OSA s. 95.13.

[190]OSA s. 95.8.

shares under the bid, since the seller of securities in the market avoids the requirement of *pro rata* taking up, and this should not affect those who tender their shares to a circular bid.

If the offeror does not pay for the securities simultaneously with their taking up, he is required to do so within three days after taking them up.[191]

If the term of the bid is more than 21 days, it is possible that after the offeror has taken up and paid for some securities, more securities are deposited under the bid. In this case, the offeror is required to take up and pay for such subsequently deposited securities within ten days of the date of their deposit.[192] However, it is not quite clear how the *pro rata* requirement will work here.

6. Financing Arrangements

Where the consideration for the shares deposited under a takeover bid is to be paid in cash, or at least partly in cash, prior arrangements should be made by the offeror to have adequate financing to purchase all the shares that the offeror has offered to acquire under the bid.[193] This requirement does not apply if the following three criteria are met: (1) there is no published market for the securities subject to the bid; (2) purchases are to be made from not more than five entities in the aggregate; and (3) the bid is not made to shareholders generally.[194]

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[191]OSA s. 95.10. Sometimes, the OSC finds it possible to change this requirement. For example, in *Re Rogers Communications Inc.*, March 31, 1994 O.S.C.B. 1531, an exemption was permitted from the three-day payment period following take-up where the lenders of $2 billion of the purchase price required a minimum of three business days prior notice to drawdown. Alboini, *supra* note 135, §20.9.8.

[192]OSA s. 95.11.

[193]OSA s. 96.

[194]Regulation 184.

7. Consideration Rules

Consideration rules are designed to ensure that there is no discrimination among target shareholders tendering their shares under one and the same bid.

It is imperative that all holders of securities subject to the bid are offered identical consideration.[195] "Identical" means here that the consideration offered to different shareholders should not only be equivalent in value, but it should be virtually the same. For example, if some shareholders are offered cash, others should also be offered cash, they cannot be offered securities which are valued by the offeror at the same amount. Sometimes it is not sufficient to offer identical consideration in one transaction. If several transactions are subject to integration with the takeover bid under s. 94(5), offerees in each of the transactions must be offered identical consideration, or offerees under a circular or a stock exchange bid must be offered the highest identical consideration for the highest percentage of offeree shares purchased in a transaction entered into within 90 days prior to the takeover bid.

The offeror's obligation to offer identical consideration is subject to regulations. Reference can be made to Regulation 184 described above which exempts a bid conforming to criteria established therein from the requirements of sections 95-100 of the OSA, including the requirement of identical consideration.

The offeror is precluded from entering into any collateral agreement, commitment or understanding with any holder or beneficial owner of target securities to the effect that such holder or beneficial owner receives a consideration of greater value than that offered to other holders or beneficial owners of the same class of shares.[196] The purpose of such approach was stated in the Practitioners Report on p. 1:

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[195] OSA s. 97(1).

[196] OSA s. 97(2).

"In addition, we believe that shareholders of an offeree issuer and public investors generally should be confident that transactions which may affect the de facto control of public security issuers will be made, as a matter of principle, on a basis which requires identical treatment of holders of the same class of securities and that all such shareholders will have an equal opportunity to participate in the benefits which may accompany a change of effective control of public issuers."

Note that the prohibition of collateral agreements does not apply to exempt takeover bids.

An attempt to generalize what collateral agreements are permitted under s. 97(2) was made by the OSC in *CDC Life Sciences Inc.*[197] The following test was suggested by the OSC: a collateral agreement is permitted when there is a clearly established business or financial purpose related either to the terms upon which the offeror is prepared to acquire the target company or to its ongoing operation.

Where the offeror increases the consideration payable under a takeover bid during the time of the bid, all shareholders who have tendered their shares under the bid must receive such increased consideration, irrespective of the time when their shares were taken up.[198] Note that a seller in a transaction preceding the takeover bid, even if such transaction is subject to pre-bid integration, does not have a right to claim an increased consideration. A vendor in a private agreement preceding the bid who has received the consideration lower than those tendering under the bid may claim identical consideration under s. 97(1), but only if he can prove that the two transactions comprise one and the same takeover bid.[199] Practically, this may be rather difficult to establish.

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[197]June 17, 1988 O.S.C.B. 2541.

[198]OSA s. 97(3). There are scholars who doubt the economic reasonableness of this provision and its consistency with the "perfect market" objective. Others contend that only a disclosure of a possible price increase is sufficient. But the latter suggestion can do more harm than good to offerors since the shareholders will deter from depositing their shares in anticipation of an announcement of a price increase, and if the offeror does not disclose a price increase, he will be precluded from increasing the price later. See the discussion in Anisman, *supra* note 72, p. 90.

[199]Further clarifications of this issue can be found in O.S.C. Policy No. 9.3. Private agreements should be considered for the purposes of determining if the same consideration is being offered to tendering shareholders under a takeover bid when such private agreements are entered into by the

8. Takeover Bid Circular

A takeover bid circular as a document providing shareholders with sufficient information about the bid was originally recommended by the Kimber Committee.[200] Since then, a takeover bid circular is required to be delivered by an offeror with or as part of a takeover bid.[201] The contents of the circular should correspond to Form 32.[202] When a bid is made, an offeree usually receives an offer to purchase with a transmittal letter. By signing the transmittal letter, the offeree accepts the bid, and upon delivering the signed transmittal letter and the offeree's share certificates to the designated depositary, a contract is made between the offeror and the offeree. Even if the circular is not part of the bid, its purpose is to induce the offeree to enter into a contract, and any false or misleading information in the circular may give rise to the offeree's common law action for damages if such information can be qualified as misrepresentation[203] or warranty.[204] When a circular forms part of the bid, i.e. when it is part of the same document, it can be

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purchaser with the intention of making a takeover bid at a later date. As it is practically impossible to prove intention, especially in a past transaction, the OSC established the criterion of 180 days from the date of the private agreement to the date of the takeover bid. If a takeover bid is made within this period, the intention is presumed. Alboini, *supra* note 135, §20.11.1.

[200] Kimber Report, para. 3.23.

[201] OSA s. 98(1).

[202] Additional information, however, may be required by other legislation. If, for example, the target company is formed in accordance with the CBCA, the offeror should take into account the requirements of Canada Business Corporations Regulations s. 59, when the bid is made under subsection 198(1) of the CBCA, or s. 60, when the bid is a share-for-share bid under s. 200 of the CBCA. For example, in *Re Royal Trustco* v. *Campeau Corp.* (No. 1) (1980), 31 O.R. (2d) 130 (C.A.), the offeror was ordered by the Court to provide more disclosure information to all shareholders of the target corporation, which was a CBCA corporation, about the impact of the offeror's operations in Florida should its bid be successful. See Alboini, *supra* note 135, §20.12.1.

[203] *E.g.*, *Hedley Byrne & Co. Ltd.* v. *Heller & Partners Ltd.*, [1964] A.C. 465, [1963] 2 All E.R. 575.

[204] *E.g.*, *Dick Bentley Productions Ltd.* v. *Harold Smith Motors Ltd.*, [1965] 2 All E.R. 65, [1965] 1 W.L.R. 623, *Esso Petroleum Co.* v. *Mardon*, [1976] Q.B. 801, [1976] 1 All E.R. 5 [collateral warranty].

considered as being part of the contract, and in determining liability for untrue statements different contractual common law principles may apply.[205]

A takeover bid circular should contain extensive information about the offeror,[206] his ownership of and trading in the target company securities, terms and conditions of the bid, including all applicable time periods, particulars of payments for deposited securities, information about any relevant commitments and arrangements of the offeror, the right of appraisal and acquisition, if any, and information about other material facts. When securities are offered in exchange for the target securities, prospectus-like disclosure is prescribed by Form 32, Item 15. When the offeror is a company, the contents of the circular should be approved and the sending of the circular should be authorized by the offeror's directors.[207]

The disclosure required by the OSC is rather extensive. However, there were precedents when the OSC has issued exempting orders under s. 104(2)(c) varying disclosure requirements.[208]

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[205] *E.g.,Leaf* v. *International Galleries*, [1950] 2 K.B. 86 (C.A.).

[206] It is required now to disclose the offeror's identity in all circumstances, whether the bid is for cash or securities. As you may recall, the Kimber Committee recommended that an offeror in an all cash bid need not disclose his identity because, in the opinion of the Kimber Committee, the decisive factor for the offerees in a cash bid was the price (Kimber Report, para. 3.18). However, price is not always the most important element motivating the shareholders' decision. As it was noted in the Merger Report (para. 7.32), offeree shareholders should be entitled to know with whom they may be associated and who is going to control the corporation, especially if they decide not to tender their shares.

[207] Form 32, Item 22.

[208] For example, in *Re Consolidated Electrical Distributors, Inc.*, April 14, 1995 O.S.C.B. 1684, the OSC granted to the offeror an exemption from the prospectus-like disclosure requirements. The consideration payable under the bid consisted partially of cash and partially of preferred shares of the offeror which shares were to be redeemed by the offeror on the day following the take-up and payment date. The OSC was convinced that the preferred share option was another means of paying cash to the offerees and was introduced solely for tax purposes. In any case, exempting orders are not issued after the disclosure materials have been mailed to Ontario residents. Notice, June 25, 1982 O.S.C.B. 359A, in Alboini, *supra* note 135, §20.12.1.

9. Change and Variation

Offeree shareholders largely rely on the takeover bid circular in making their decision to accept or reject the bid. Thus, when a change occurs in the information contained in the circular, and the bid has not expired yet or the offerees still have a right to withdraw their shares,[209] offerees have a right to be aware of such a change. The criterion of a change that the offerees must be made aware of is that such change would reasonably be expected to affect the offerees' decision to accept or reject the bid.[210] The notice of change should contain information prescribed by Regulation 193[211] and should be delivered[212] not to all offerees to whom the takeover bid circular was required to be delivered, but only to those security holders whose shares have not yet been taken up at the date of the occurrence of the change.[213]

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[209]If the original 21-day withdrawal period has expired, the next period when offerees have a right to withdraw their shares is after 45 days from the date of the bid if their shares have not been taken up and paid for by the offeror. If a change occurs within this withdrawal period, offerees are granted an additional 10-day period to reconsider the bid. OSA s. 95.4.

[210]OSA s. 98(2).

[211]Namely, such information includes:
(a) a description of the change in the circular;
(b) the date of the change;
(c) the date up to which securities may be deposited;
(d) the date by which the deposited securities must be taken up by the offeror; and
(e) the rights of withdrawal that are available to security holders.

In addition to the above information, the notice of change should be accompanied by a duly signed certificate in the form required under Form 32 amended to refer to the initial circular and all notices of change thereto. Regulation 193.

[212]The OSC may exempt an offeror from delivering the notice of change or variation to each offeree personally. In *Re Maxx Petroleum Ltd.*, November 12, 1993 O.S.C.B. 5481, the offeror was allowed to publish a summary of material facts in a major newspaper. Alboini, *supra* note 135, §20.12.2.

[213]Alboini is concerned that such restriction of the recipients of the revised takeover bid circular might not be fair to those who have tendered under the original bid and whose shares have been already taken up and paid for. However, the potential prejudicial effect of such restriction is reduced by the following factors: (1) the practice is that most offerees do not deposit their shares under a takeover bid until the last week of the deposit period; and (2) an offeror cannot take up the deposited securities before 21 days from the date of the bid have expired. Nevertheless, this restriction in s. 98(2), as well as in s. 98(4), which contains a similar provision with regard to variation in bid terms, presents a further reason for the practice not to deposit shares under a bid early to continue. See Alboini, *supra* note 129, pp. 714-715.

The requirement of a notice of change does not apply if the change is beyond the control of the offeror or its affiliates.[214] However, if there is a change in a material fact relating to the securities being offered in exchange for the target securities, the offeror is obliged to disclose it in a notice of change. A material fact in relation to securities is defined by s. 1(1) of the OSA as "a fact that significantly affects, or would reasonably be expected to have a significant effect on, the market price or value" of the securities.

Upon receipt of a notice of change, offeree shareholders are given another ten days to withdraw their shares,[215] but the deposit period is not extended.

An offeror has a right to change the bid terms even after some securities have been already taken up under the bid. Variation in bid terms most often relates to the consideration offered for the target securities in response to a competing bid. There can also be an extension of the bid term, a change in the nature or attributes of securities offered in exchange for the target securities, or a change in the conditions to a bid. In every case when there is a variation in the terms of a takeover bid the offeror should deliver[216] a notice of variation[217] to every offeree who was entitled to receive the takeover bid circular and whose shares under the bid have not yet been taken up.[218]

Upon receipt of a notice of variation offeree shareholders have an additional period of ten days to withdraw their shares[219] and a minimum period of ten days to

[214]OSA s. 98(3).

[215]OSA s. 95.4.ii.

[216]Sometimes, offerors are permitted to extend the bid period by issuing a press release rather than delivering the notice of variation to each offeree shareholder. For example, in *Re Lac Minerals Ltd.*, August 26, 1994 O.S.C.B. 4113, and in *Re American Barrick Resources Corporation*, August 26, 1994 O.S.C.B. 4114, in Alboini, *supra* note 135, §20.12.3.

[217]The form and contents of the notice of variation should correspond to Regulation 193.

[218]OSA s. 98(4).

[219]OSA s. 95.4.ii.

deposit shares under the bid.[220] If, however, a variation of an all cash bid consists solely of the waiver of a condition to the bid, an additional ten days deposit period is not granted.[221]

A variation cannot be made after the deposit period has expired except for the offeror's waiver of a condition that is specifically stated in the bid as being waivable at the offeror's sole option.[222] In this case, there is no obligation to deliver a notice of variation as long as the bid is all cash. However, a press release concerning the waiver must be issued within five days after the deposit period. For the purpose of variations made after the expiry of the deposit period, the deposit period is defined as the period, including any extension, during which securities may be deposited under the bid.[223]

10. Directors' Circular

Originally, in the 1966 OSA, the directors' circular was not mandatory. The directors of the offeree company could choose either to provide their opinion on the bid to the offeree shareholders or to refrain from it. The original takeover bid legislation followed the approach of the Kimber Committee which did not consider directors to be in the position to give investment advice.[224] The above point of view was also shared in the

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[220] OSA s. 98(5). If a notice of variation is delivered earlier than 10 days before the expiration of the deposit period, the deposit period is not extended. If the notice is delivered within the last 10 days of the deposit period, it is extended for 10 more days.

[221] OSA s. 98(6).

[222] An offeror is not free to waive a condition to the bid in any manner he thinks fit. If, for example, a bid is conditional upon acceptance by 90% of holders of Class A shares and by 90% of holders of Class B shares, and less than 90% of shares are tendered in both cases, the offeror cannot waive the condition with respect to Class B shares only and take up Class B shares. A condition should be exercised in accordance with its terms. Otherwise, the offeror should have made two separate offers to different classes of shares. *Rolland Inc. v. Cascades Inc.*, 1987 O.S.C.B. 1629 in Alboini, *supra* note 135, §20.9.8.

[223] Regulation 195(1)-(3).

[224] Kimber Report, para. 3.13.

Merger Report which did not want to make the directors give their opinion on the bid when there was no unanimity between them.[225]

This approach was changed in the Hodgson Report where it was noted that one could think of no valid reason why the issue of a directors' circular should depend on whether the directors propose to recommend acceptance or rejection of the bid, and suggested that shareholders be entitled to receive adequate information about the bid in any case.[226]

The current OSA follows the recommendation of the Hodgson Report. S. 99(1) of the OSA requires the directors of the offeree company to prepare and deliver a directors' circular to every person and company to whom a takeover bid must be delivered not later than ten days after the date of the bid. However, now the directors cannot recommend anything to the shareholders or refrain from making a recommendation unreasonably. Whatever they choose, to recommend acceptance or rejection of the bid or to state that they are unable to make or are not making a recommendation, their respective reasons should be included in the directors' circular.

Generally, a directors' circular should be sent to the offeree shareholders within ten days after the date of the bid.[227] However, if the directors state in the circular that they are considering recommending acceptance or rejection of the bid, a circular may be delivered to the shareholder later, but at least seven days before the bid expiry date.[228] So, if the bid is open for 21 days, the directors have an extra four days to form their opinion.

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[225]Merger Report, paras. 7.27 - 7.30.

[226]Hodgson Report, Chapter 13.

[227]OSA s. 99(1).

[228]OSA s. 99(5).

The contents of the directors' circular is prescribed in Form 34. The following major changes may be noted in comparison with the 1966 legislation requirements:

- The names of the offeror, offeree and its directors should be stated in the circular.
- If there is any agreement between the offeree company and its directors or senior officers, it should be disclosed in the directors' circular.
- The directors' circular should disclose all trading in the securities of the offeree company within six months prior to the bid, including the number of securities traded, their purchase or sale price, and the date of each transaction. Such disclosure is required with respect to each director, senior officer, their associates, or any person holding more than 10% of a class of equity securities of the offeree company.
- If the directors notice that any information provided in the takeover bid circular is incorrect or misleading, such information should be corrected.
- The directors should recommend to shareholders acceptance or rejection of the bid and the reasons therefor, or if the board of directors is unable to make and is not making any recommendation, respective reasons should also be provided.
- The directors' circular should disclose any response by the offeree company to the takeover bid, i.e. any resolution passed by the board or any transaction, agreement in principle or signed contract entered into by the offeree in response to the bid.

- A major requirement of Form 34 is to disclose any defensive tactics contemplated by the offeree board of directors in response to the bid. If any negotiations are underway that would result in an extraordinary transaction (i.e. merger, reorganization) involving the offeree or its subsidiary, the transfer of a material amount of assets by the offeree or its subsidiary, an issuer bid or other acquisition of securities by or of the offeree, or any material change in the present capitalization or dividend policy of the offeree, the fact of such negotiations should be disclosed. Moreover, if an agreement in principle has been reached, full particulars of such agreement should be provided. Some commentators are of the opinion that the disclosure required by this section of the directors' circular is unrealistic.[229] When no agreement in principle has been reached, all information available to the directors is rather uncertain, and any disclosure could prevent the directors from completing the transaction according to their expectations. On the other hand, if an agreement has been reached, the fact of its disclosure could restrain the ability of the offeree company to defeat a hostile takeover bid.

Sometimes, the directors of the offeree company may be exempted from the obligation to submit the directors' circular.[230]

An individual director or officer of the offeree company may choose to prepare his own circular and recommend acceptance or rejection of a takeover bid.[231] The only condition here is that such recommendation should be made in the form of a circular in

[229]See Alboini, *supra* note 135, §20.13.1.

[230]*E.g.*, in *Re Russel Holdings Limited* (February 12, 1988 O.S.C.B. 743), competing bids became subject to cease trading orders, and directors of the offeree company were exempted from submission of a directors' circular. In *Re Clearwater Limited Partnership* (April 30, 1993 O.S.C.B. 1974), an exemption from the delivery of a directors' circular was granted on condition that certain information which was to be provided in the directors' circular should instead be provided in the takeover bid circular.

[231]OSA s. 99(3).

accordance with the regulations.[232] Unlike the directors' circular, there is no legislative requirement that an individual director's or officer's circular be submitted by a particular date.

Where a change occurs in the information contained in the directors' circular, the directors are required to deliver a notice of change and disclose the nature and substance of the change.[233] Two issues should be noted here: (i) such change should occur before the takeover bid expiry date, or after such date but before the expiry of all withdrawal rights; and (ii) such change would reasonably be expected to affect the decision of the offeree shareholders to accept or reject the bid. The same rule is applicable to an individual director's or officer's circular, but for one exception: it is not required to deliver a notice of change of information if such change is not within the control of the individual director or officer.[234]

A directors' circular or an individual director's or officer's circular, or any notice of change thereof, that is delivered to the offeree shareholders must also be delivered to the offeror and the OSC.[235] The law does not specify whose obligation it is to deliver the circulars to the OSC. Presumably, this is the obligation of the board of directors of the offeree company.[236]

11. Reports of Acquisition

Section 101 of the OSA imposes a so-called "early warning disclosure requirement" on an offeror acquiring beneficial ownership or the power to exercise

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[232]Form 35.

[233]OSA s. 99(6).

[234]OSA s. 99(6)(b).

[235]OSA s. 100(2).

[236]Alboini, *supra* note 135, §20.14.1.

control or direction over 10 per cent or more of the issued voting or equity securities of any class of a reporting issuer. In this case, the offeror is required to issue a news release disclosing the information prescribed by the regulations and subsequently, within two business days of the acquisition, file a report containing the same information as in the news release. It is interesting to note that the early warning disclosure requirement is triggered irrespective of the manner of acquisition.

The obvious purpose of the above requirement is to inform the market immediately of a significant investment or acquisition of a control position. One of the items that should be disclosed in the news release or the subsequent report is the purpose of the transaction, i.e. the offeror should disclose whether in future he or any person or company acting jointly or in concert with him intends to increase their beneficial ownership, control or direction over the securities of the offeree. Thus, the investment community will have an opportunity to assess the reported acquisition. Note that even if the offeror does not intend to make a subsequent formal bid, he is still required to report the purchase.

The early warning disclosure requirement affects also the offeror's ability to secure a 20% block of shares less one share and delay disclosure until within ten days after the end of the month of the acquisition. Therefore, the offeror will not be able to acquire the 20% block of shares less one share in the market anonymously prior to making a formal bid.

Moreover, if the offeror or its joint actor acquires an additional 2% or more of the voting or equity shares of the offeree, he is required to report such purchase. A supplementary report should also be filed if there is a change in any other material fact stated in the report. The procedure is the same, a news release should be issued simultaneously with the change, and a report should follow within two business days.

There are also certain restrictions on acquisitions during the period commencing on the occurrence of an event in respect of which a report is filed and terminating on the expiry of one business day from the date of filing of the report.[237] During such period, the offeror or any person or company acting jointly or in concert with the offeror is not allowed to purchase any securities of the class in respect of which the report has been filed. One day delay gives the market an opportunity to react to the reported purchase and, probably, to modify investment policy accordingly.

The requirement of one day freeze upon acquisition of 10 per cent of securities of a class does not mean that an offeror is prohibited from acquiring more than 10 per cent of securities of a class in a single transaction. On the other hand, once the purchase may be qualified as one transaction, the freeze will not be triggered.[238] The freeze requirement does not apply to an offeror who already has beneficial ownership or control or direction over at least 20 per cent of target securities. In this case, the takeover bid threshold is reached and circular bid requirements come into play, unless the offeror may rely on an exemption.

When a formal bid is outstanding, disclosure requirements apply to any offeror, other than the bidder, acquiring securities of the offeree company subject to the bid.[239] Disclosure is required once such offeror's holding of the offeree shares, including the shares owned or controlled by its joint actor, amount to 5% or more of the offeree shares. The offeror is required to issue a news release containing the information prescribed by the regulations and file its copy with the OSC. The evident purpose of this requirement is to let the investment market know that a competing bidder may be interested to make a formal bid. The disclosure obligation does not apply if the offeree company is not a reporting issuer.

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[237]OSA s. 101(3).

[238]See Alboini, *supra* note 135, §20.15.1

[239]OSA s. 102(1).

If an offeror who has made a disclosure under s. 102(1) of the OSA or its joint actor acquires an additional 2% or more of the offeree shares, a similar public disclosure obligation is imposed on the offeror pursuant to s. 102(2) of the OSA. He is required to issue a further news release according to the prescribed form and file a copy with the OSC. Though it is not expressly stated in s. 102(2), the obligation of public disclosure of additional purchases of 2% of the offeree shares does not apply if such purchases are made after the expiration of the formal bid.[240]

12. Powers of the OSC and the Court Upon Application

Pursuant to s. 104, upon an application by an interested person, the OSC has wide powers to impose orders or grant relief from the requirements of Part XX of the OSA. The definition of an "interested person" includes the offeree issuer, its security holder, director or officer, the offeror, the Director or any other proper person in the opinion of the OSC.[241]

The powers of the OSC are rather broad. It may restrain the distribution of any document used or issued in connection with a takeover bid, including the bid, directors' or officers' circulars, individual director's or officer's circular or notice of change or variation, or any other correspondence in connection with the bid. The OSC may also require any person to amend or vary any such document and have such amended or varied document distributed. It may also direct any person or company to comply with Part XX of the OSA or the related regulations. The broad powers of the OSC are subject to one limitation: it should appear to the OSC that a person has not complied or is not complying with Part XX or the related regulations.

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[240]Alboini, *supra* note 135, §20.16.1.

[241]OSA s. 89(1). *E.g.*, in *Re Core Mark International Inc.*, August 18, 1989 O.S.C.B. 3185, it was held that a competing offeror is also a proper person for the purposes of s. 104.

When the OSC is satisfied that it is not prejudicial to the public interest, it may exempt an agreement from the requirements of s. 97(2) regarding identical consideration,[242] vary any time period imposed by Part XX, or exempt any person or company from any of the requirements of Part XX or the related regulations.[243]

An interested person may also apply to the Ontario Court (General Division) for an order under s. 105. In contrast to the jurisdiction of the OSC under s. 104 where the OSC should establish only the appearance of non-compliance, the judge, before making any interim or final order he thinks fit, should receive enough evidence to be satisfied that a person or company has not complied with Part XX or any related regulations. Once the Court determines the fact of non-compliance, it may, without limitation, award compensation to an interested person, rescind a transaction, require the sale of securities acquired under a takeover bid, prohibit any person from exercising voting rights or require the trial of an issue. Although the powers of the Court with respect to the choice of an appropriate remedy are rather broad, the Court's order with respect to a takeover bid should not be "too draconian in relation to discrepancies and anomalies which are found in the takeover bid documentation," as noted by Mr. Justice Greenberg in *Nordair Inc. v. Quebecair.*[244]

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[242] There have been a number of takeover bids where the OSC issued orders pursuant to s. 104(2)(a). For instance, in *Re Levesque Beaubien and Company Inc.*, September 30, 1988 O.S.C.B. 3979, the OSC issued an order permitting the bidder to enter into agreements with certain target employees-shareholders to provide for their continued employment and equity participation in the target company. Alboini, *supra* note 135, §20.11.5.

[243] *E.g.*, in *Re Rogers Communications Inc.*, February 24, 1989 O.S.C.B. 777, the transfer by a parent company of a controlling interest in a target company to its two subsidiaries was exempted from Part XX requirements due to the transfer not resulting in any change in effective control by the parent company. *Ibid.*

[244] 1985, 32 B.L.R. 253.

approval for defensive tactics, however, the OSC is less likely to intervene, though, as we shall see below, a shareholder approval does not place the defensive tactics out of reach of the OSC.

It was first acknowledged in the Practitioners Report that the primary focus of the securities legislation was on the bidder, while the conduct of the target management fell out of statutory regulation and was not subject to any regulatory restraints.[246] Although the Practitioners Report did not recommend any specific rules, it raised the question of adoption of restraints on certain types of conduct by the target management once a takeover bid is made. Nevertheless, National Policy 62-202 is against prescribing a written code of conduct for the target directors as any fixed rules run the risk of containing provisions that may be insufficient in some cases and excessive in others. The assessment of propriety of adoption of defensive tactics in each particular case is left for consideration by courts, and below we shall see how the courts approach this issue.

In the late 1980s - 1990s the so-called "poison pill," or a shareholder rights plan, became one of the most popular defensive tactics. Typically, it works as follows: A corporation distributes to its shareholders rights to acquire common shares at a discount price. The rights carry no vote and initially trade with the shares. They may also be redeemed by the board before a "triggering event" occurs or for a short period thereafter. The rights become exercisable upon occurrence of a stipulated triggering event. Usually, it is the accumulation by a party of a certain percentage of the company's common shares or the announcement of a takeover bid. At this point, the rights separate from the shares and may be exercised by all shareholders except for the acquirer or bidder. The purpose of the poison pill is to dilute the bidder's share and make the acquisition extremely expensive for him.[247]

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[246]*Supra* note 45.

[247]G. Coleman, "Poison Pills in Canada" *(1989) 15 Can. Bus. L.J. 1*, at pp. 1 - 2.

approval for defensive tactics, however, the OSC is less likely to intervene, though, as we shall see below, a shareholder approval does not place the defensive tactics out of reach of the OSC.

It was first acknowledged in the Practitioners Report that the primary focus of the securities legislation was on the bidder, while the conduct of the target management fell out of statutory regulation and was not subject to any regulatory restraints.[246] Although the Practitioners Report did not recommend any specific rules, it raised the question of adoption of restraints on certain types of conduct by the target management once a takeover bid is made. Nevertheless, National Policy 62-202 is against prescribing a written code of conduct for the target directors as any fixed rules run the risk of containing provisions that may be insufficient in some cases and excessive in others. The assessment of propriety of adoption of defensive tactics in each particular case is left for consideration by courts, and below we shall see how the courts approach this issue.

In the late 1980s - 1990s the so-called "poison pill," or a shareholder rights plan, became one of the most popular defensive tactics. Typically, it works as follows: A corporation distributes to its shareholders rights to acquire common shares at a discount price. The rights carry no vote and initially trade with the shares. They may also be redeemed by the board before a "triggering event" occurs or for a short period thereafter. The rights become exercisable upon occurrence of a stipulated triggering event. Usually, it is the accumulation by a party of a certain percentage of the company's common shares or the announcement of a takeover bid. At this point, the rights separate from the shares and may be exercised by all shareholders except for the acquirer or bidder. The purpose of the poison pill is to dilute the bidder's share and make the acquisition extremely expensive for him.[247]

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[246] *Supra* note 45.

[247] G. Coleman, "Poison Pills in Canada" *(1989) 15 Can. Bus. L.J. 1*, at pp. 1 - 2.

The Canadian case law on the subject is rather scarce. The poison pill is not so widely accepted in Canada as in the United States, and the American approach is often followed. Not to repeat what was previously written on the subject,[248] in this chapter, only the most significant decisions of the OSC and some other provincial securities commissions as well as court decisions with respect to defensive tactics taken, with a few exceptions, in the last decade will be analyzed.

B. Decisions of the Ontario Securities Commission

During the last decade, there were a number of notable decisions of the securities regulatory authorities with respect to defensive tactics adopted by target companies in anticipation of a takeover bid.

In *Jorex*[249] and in two subsequent cases, *Lac*[250] and *Regal,*[251] the OSC described its role in reviewing defensive tactics. In *Jorex* the OSC stated that its purpose was not to review the conduct of the target board of directors or rule whether it was appropriate for the board to have adopted the rights plan. Rather, the OSC was to answer the question whether the rights plan had served its purpose of facilitating an auction for the target company, and so ought to be discontinued to let the shareholders decide which bid they

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[248]E.g., Coleman, *ibid*; P. Dey & R. Yalden, "Keeping the Playing Field Level: Poison Pills and Directors' Fiduciary Duties in Canadian Take-Over Law" *(1990) 17 Can. Bus. L. J. 252*; J. W. Forsyth, "Poison Pills: Developing a Canadian Regulatory and Judicial Response" *(1991) 14 Dal. L. J. 158*; J. G. MacIntosh, "The Poison Pill: A Noxious Nostrum for Canadian Shareholders" *(1989) 15 Can. Bus. L. J. 276*; J. G. MacIntosh, "Poison Pills in Canada: A Reply to Dey and Yalden" *(1991) 17 Can. Bus. L. J. 323*; S. Wishart, "Are Poison Pills Illegal?" *(1998) 30 Can. Bus. L. J. 105*; R. Yalden, "Controlling the Use and Abuse of Poison Pills in Canada: *347883 Alberta Ltd. v. Producers Pipelines Inc.*" *(1992) 37 McGill L. J. 887*.

[249]*Re Canadian Jorex Limited and Mannville Oil & Gas Ltd.*, (1992), 15 O.S.C.B. 257 (hereinafter, "*Jorex*").

[250]*Re Lac Minerals and Royal Oak Mines Inc.*, (1994), 17 O.S.C.B. 4963 (hereinafter, "*Lac*").

[251]*Re MDC Corporation and Regal Greetings & Gifts Inc.*, (1994), 17 O.S.C.B. 4971 (hereinafter, "*Regal*").

preferred.[252] The OSC held that in this case the rights plan had served its purpose of facilitating a rival bid and time had come for it to go so that the target shareholders could decide under which bid to trade their shares. In arriving to the above conclusion, the OSC analyzed three issues and determined the following facts. First, the bid in question could not proceed with the rights plan in place. Second, with the rights plan in place, any further enhancement of the bid was unlikely. And third, the existence of the rights plan was not likely to facilitate a competing bid. Thus, the rights plan had to go.

In *Lac* the same basic question was before the OSC, namely, if the time had come for the poison pill to go. However, in this case the OSC held that it was in the public interest and in the interests of the target shareholders who had approved the plan that the rights plan remain in effect because at the time of hearing the target shareholders' interests were not prejudiced by its operation.

In *Regal* the approach was further developed, and two principal questions were identified that should be answered by securities regulatory authorities in determining whether the poison pill had to go. First, if the plan is permitted to remain in effect for a reasonable further period, is there, on the evidence available, a reasonable possibility that a better offer will emerge during such period? Second, if the pill is not terminated prior to the bid's expiry date, is it likely that the bid will not be extended by the offeror for such reasonable further period and thus target shareholders will be deprived of the opportunity to decide whether or not they wish to sell their shares under the bid?[253] Another fundamental question was also before the OSC, and the question was what the position of the target shareholders was with respect to the rights plan. The OSC pointed out that it was not willing to conclude that the rights plan was to stay or to go if the target

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[252] *Supra* note 249, at p. 263.

[253] *Regal, supra* note 251, at p. 4979.

shareholders felt otherwise.[254] In this case, the shareholder support for the rights plan at the time of hearing was evident, so the OSC decided not to intervene.

The approach set out in *Jorex* and followed in *Lac* and *Regal* was further followed in *Tarxien*.[255] Once again, the OSC pointed out the limited scope of the review it was prepared to undertake. It was not going to assess the validity or legal enforceability of the rights plan in the absence of shareholder approval or to rule whether the target directors had exercised their fiduciary duties. The OSC referred the above issues to the consideration by the courts.[256] As in the above cases, the OSC asked whether time had come to strike down the rights plan. Answering in the affirmative, the OSC noted that there had been an active auction for the target shares and the ultimate choice among the competing bids had to be left to the shareholders[257].

The *Regal* test was further developed in *WIC*[258] which was a joint decision of the Ontario, Alberta and British Columbia securities commissions. The commissions showed their preference to rights plans approved by target shareholders prior to the bids. If, however, a rights plan was adopted in the face of a bid and was not duly approved by the shareholders, the target company, at the very least, should demonstrate that it was necessary to do so because of the coercive nature of the bid or some other substantial unfairness or impropriety.[259] In *WIC*, the target company did not demonstrate it, so the commissions decided that the plan had to go.

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[254] *Ibid*, at p. 4980.

[255] *Re The Tarxien Corporation and Ventra Group Inc.*, (1996), 19 O.S.C.B. 6913 (hereinafter, "Tarxien").

[256] *Ibid*, at p. 6917.

[257] *Ibid*, at p. 6919.

[258] *Re CW Shareholdings Inc. and WIC Western International Communications Ltd.*, (1998), 21 O.S.C.B. 2899 (hereinafter, "*WIC*").

[259] *Ibid*, at p. 2908.

A similar reasoning was used by the Ontario and Quebec securities commissions in *Cambridge*.[260] The two principal issues before the commissions were (i) to decide whether the rights plan adopted in the face of the bid and not approved by the shareholders was permitted to stand, and (ii) if the plan was permitted to stand, whether the time had come for it to be terminated by the commissions.[261] Here, it was held that the bid was coercive, and the plan was permitted to stand.

It is interesting to note a decision taken by the Alberta Securities Commission with respect to defensive tactics in 1999. In *Highridge*,[262] the Alberta Securities Commission considered the above OSC decisions on poison pills but stated that *WIC* and *Cambridge* involved unique facts and thus did not create a new test for determining whether a pill adopted by the target company's board of directors in the face of a takeover bid without shareholder approval must go. Nor did it consider *WIC* and *Cambridge* as elevating coerciveness to the level of a decisive factor, but was rather of the view that the *Regal* test was fundamental for the review of all rights plans. According to the interpretation of the Alberta Securities Commission, *Cambridge* meant that coerciveness was a significant factor in the consideration of whether a target had met its burden under the *Regal* test. Coerciveness might suggest a special need for increasing shareholder choice or influence the determination of what was a reasonable period of time for the pill to stand.

A significant development was the 1999 decision of the British Columbia Securities Commission in *Argentina Gold*.[263] The Commission pointed out that in

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[260] *Re Ivanhoe III Inc. and Cambridge Shopping Centres Limited*, (1999), 22 O.S.C.B. 1327 (hereinafter, "*Cambridge*").

[261] *Ibid*, at p. 1329.

[262] *Re Samson Canada Inc. and Highridge Exploration Ltd.*, (1999) 8 A.S.C.S. 1791 (hereinafter, "*Highridge*").

[263] *Re BGC Acquisition Inc. and Argentina Gold Corp.*, [1999] 25 B.C. S.C.W.S. 44 (hereinafter, "*Argentina Gold*").

determining whether a poison pill had to stay or to go another factor should be noted. This factor is the balance of interests between target shareholders who should be free to decide for themselves, as described in *Jorex*, and target management who should fulfill what they see as their fiduciary duties, as set out in *Regal*. The decision in *Argentina Gold* outlined the relevant factors that should be considered in striking a balance between the above two objectives in each particular case. These relevant factors include: (i) whether shareholder approval was obtained; (ii) whether broad shareholder support is evident; (iii) when the poison pill was adopted; (iv) the nature of the bid, including whether it is coercive or unfair to the target company shareholders; (v) the size and complexity of the target company and the number of potential, viable offerors; (vi) the likelihood of the existing bid or bids falling away if the pill is not removed; and (vii) the likelihood that, if given further time, the target company can find a better offer.[264]

Another major step in the development of the OSC approach to defensive tactics and, in particular, to poison pills, is the decision in *Royal Host*.[265] The decision was jointly taken by three major provincial securities commissions, Ontario, Alberta and British Columbia. The commissions opted for a flexible approach to be taken in consideration of poison pill cases. The principal question remained the same, whether it was time for the poison pill to go. In answering this question, the commissions referred to the general principles set out in National Policy 62-202 and stressed that in applying these principles to the determination of the public interest in each particular case an appropriate balance should be found in permitting target directors to fulfill their fiduciary duties and maximize shareholder value and protecting the target shareholders' right to decide whether to trade their shared under the bid. A list of relevant factors was outlined that should be generally taken into consideration in determining such balance. These factors may vary from case to case, but frequently the following factors will be considered:

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[264] *Ibid*, at p. 54.

[265] *Re Royal Host Real Estate Investment Trust*, (1999), 22 O.S.C.B. 7819 (hereinafter, "*Royal Host*").

- whether shareholder approval of the rights plan was obtained;
- when the plan was adopted;
- whether there is broad shareholder support for the continued operation of the plan;
- the size and complexity of the target company;
- the other defensive tactics, if any, implemented by the target;
- the number of potential, viable offerors;
- the steps taken by the target company to find an alternative bid or transaction that would be better for the shareholders;
- the likelihood that, if given time, the target company will be able to find a better bid or transaction;
- the nature of the bid, including whether it is coercive or unfair to the shareholders of the target company;
- the length of time since the bid was announced and made; and
- the likelihood that the bid will not be extended if the rights plan is not terminated.[266]

The OSC noted that it did not attempt to establish a comprehensive and conclusive test for all cases. As the OSC put it, "it is fruitless to search for the "holy grail" of a specific test that can be applied in all circumstances."[267] It pointed out that while other decisions may try to refine this approach by paying special attention to certain factors, it is impossible to establish a universal test, and all factors should be considered on a case-by-case basis.

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[266] *Ibid*, at p. 7828.

[267] *Ibid*.

The *Royal Host* approach was applied in the 2000 joint decision of the Ontario and Manitoba securities commissions in *Consolidated Properties.*[268] The commissions confirmed the position of securities regulatory authorities outlined in *Regal*, namely, if there appears to be a real and substantial possibility that, given a reasonable period of time, the target board of directors can increase shareholder choice and maximize shareholder value, then, absent some other compelling reason requiring the termination of the plan in the interests of shareholders, it seems that securities regulatory authorities should allow the plan to function for such further period, so that the target directors could fulfill their fiduciary duties.[269] The commissions also applied the *Royal Host* approach and analyzed the relevant factors to determine whether the rights plan had to go. As of the time of hearing, the commissions decided not to cease trade the rights plan, but pointed out that after a brief period they were prepared to rule otherwise.

In its most recent decision, *Chapters,*[270] the OSC confirmed that a rights plan can exist only as long as it promotes competitive bidding and gives target shareholders a choice between different bids.

In this case, the target board of directors, on becoming aware of a proposed friendly acquisition, adopted a shareholder rights plan which was later approved by the shareholders. The acquisition obviously turned into a hostile one. The target board found a "white knight" and entered into a support agreement with him. One of the provisions of the support agreement was that the rights plan would be waived as soon as the white knight would be ready to make its offer. The support agreement also contained a "no shop" provision under which the target agreed not to participate in any other acquisitions proposed by a third party. The OSC referred to National Policy 62-202 and noted that the

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[268] *Re Consolidated Properties Ltd.*, (2000), 23 O.S.C.B. 7981 (hereinafter, "*Consolidated Properties*").

[269] *Ibid*, at p. 7984.

[270] *Re Chapters Inc. and Trilogy Retail Enterprises L.P.*, citation: 2001 CarswellOnt 903, judgement of March 7, 2001 (hereinafter, "*Chapters*").

aim of the Policy was to promote an unrestricted auction process, and defensive tactics might be used by the target board only in a genuine attempt to obtain a better bid for the shareholders, and if defensive tactics that deny or severely limit the ability of the target shareholders to respond to a competing bid, they may be reviewed by securities regulatory authorities. The OSC referred to its previous decisions on rights plans in *Jorex, Regal, Royal Host* and *Consolidated Properties*. It also noted the British Columbia Securities Commission decision in *Argentina Gold*. The OSC applied the *Regal* test to see if there was a real and substantial possibility, or rather a reasonable possibility, that within a reasonable period of time the target board could increase shareholder choice and maximize shareholder value. The OSC also noted a natural tension between the target shareholders' wish to decide for themselves and the target board's fiduciary duties that they have to fulfill.

It is worth noting that in *Chapters* the OSC stressed that even the approval of the rights plan by target shareholders did not guarantee that securities regulatory authorities would not intervene. When shareholders approve a poison pill, they do not mean that it is to continue indefinitely. Neither is the target board permitted to maintain a rights plan indefinitely. It should stay for as long as the board is actively searching alternatives and there is a real and substantial possibility that the board can increase shareholder choice and maximize shareholder value.[271] Thus, once it is clear that the target board is no longer seeking alternative bids, and the rights plan eliminates shareholder choice, it is time for the rights plan to go.

On the basis of the above decisions, the current position of the OSC with respect to defensive tactics may be summarized as follows. The OSC does not think it appropriate for it to assess the legality of adoption of defensive tactics by the directors of target companies. Rather, it sees its role in deciding whether the adopted defensive tactics are likely to deny or severely limit the shareholders' ability to respond to the

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[271] *Ibid*, para. 27(a).

takeover bid or to a competing bid. An important task is to determine the appropriate balance of interests between the target directors who should be free to fulfill their fiduciary duties aimed at increasing shareholder choice and maximizing shareholder value and the target shareholders who should have the ultimate choice to decide whether to accept or reject the bid. In determining such balance, a number of issues should be taken into consideration which may differ from case to case. There is no universal test to be used in all circumstances, and the securities regulatory authorities should be rather flexible in their review. On the whole, a rights plan has a right to exist, but only for as long as it promotes competitive bidding and does not deprive shareholders of their right to take a decision. However, even if the rights plan is approved by target shareholders, it cannot last indefinitely, and it is only a matter of time when any rights plan has to go.

C. **Court Decisions**

There are not many Canadian court cases dealing directly with the adoption of defensive tactics by target companies' boards of directors in the face of takeover bids. Though the OSC referred the issue of legality of adoption of defensive tactics by boards of directors of target companies to the consideration by courts, the courts never actually questioned whether a poison pill in itself, or another defensive tactic, was legal. Rather, the courts were concerned about the directors' motives for the adoption of defensive tactics. A general approach in Canada is that directors owe fiduciary duties to the corporation and its shareholders[272] and must act in the best interests of the corporation and its shareholders. If directors, fulfilling their fiduciary duties, perceive a threat to the corporation and/or its shareholders, they are said to be entitled to take certain measures to defend them. Basically, it means that the courts agree to the directors' use of defensive tactics, but for as long as they do not cross a certain line. This line was initially known as the "proper purpose test." It states that "the directors must act in good faith. Then there

[272]As it was noted in *347883 Alberta Ltd. v. Producers Pipelines Inc.*, (1991), 80 D.L.R. (4th) 359 (hereinafter, "*Producers Pipelines*"), the corporation cannot be considered as an entity separate from its shareholders.

must be reasonable grounds for their belief. If they say that they believe there will be substantial damage to the company's interest, then there must be reasonable grounds for that belief. If there are not, that will justify a finding that the directors were actuated by an improper purpose."[273] However, the test developed in *Teck* did not identify any principles for determining whether defensive tactics adopted by the target board were reasonable in relation to the threat posed and did not pay sufficient attention to the target shareholders' right to take a decision with respect to their shares. Nevertheless, the *Teck* test was widely used by courts thereafter. Gradually, it was substituted by the "business judgement" approach which is discussed below.

The proper purpose test formulated in *Teck* was applied by Montgomery J. in *Olympia & York*.[274] Here, on becoming aware of a partial takeover bid, the target board of directors sold substantial assets of the company and caused a target's subsidiary to make a competing offer which was to be financed out of the proceeds from the sale. The bidder finally acquired control of the target and attempted to argue that the sale of assets violated the proper purpose doctrine. However, on the evidence available, the Court was satisfied that the sole purpose of the target directors' conduct was to make sure that target shareholders receive an adequate price for their shares, and all directors' actions were upheld. The Court also pointed out that wherever possible, it was preferable to have more competing offers so that the target shareholders would have a real choice and could obtain a maximum price for their shares.[275]

[273] *Teck Corp. Ltd. v. Millar* (1972), 33 D.L.R. (3rd) 288 (B.C.S.C.), at p. 315 (hereinafter, "*Teck*").

[274] *Olympia & York Enterprises Ltd. v. Hiram Walker Resources Ltd.* (1986), 59 O.R. (2d) 254 (Div. Ct.) (hereinafter, "*Olympia & York*").

[275] The position that more offers is always better than less offers was also stated by the Court in *Corona Minerals Corp. v. CSA Management Ltd.*, 68 O.R. (2d) 425, [1989] O.J. No. 576. In this case, there were two competing offers, and one of the reasons why the Court was not willing to enjoin a higher offer was that it would harm target shareholders and deprive them of the opportunity to obtain the highest price available for their shares. As it was said at p. 429, "to try and achieve the highest value for the shareholders of the target companies for their shares" was an acceptable purpose in the securities industry.

Producers Pipelines is, perhaps, an only case dealing directly with the adoption of a poison pill by the target company. Briefly, in the face of a takeover bid the board of directors of the target company adopted a shareholder rights plan, or a poison pill, allowing the shareholders to purchase 10 additional common shares at a discount price upon the occurrence of a non-permitted takeover bid. A bidder owing from 5 to 10% of the outstanding common shares of the company was not entitled to exercise any rights annexed to its common shares. The poison pill was initially adopted for 4 months, but was extended later, and it was never submitted to the target shareholders for approval, though during the time of the pill's validity two shareholder meetings were held. Another measure taken by the board was to announce an issuer bid. The applicant requested to set aside the rights plan and the issuer bid arguing that the board's actions were oppressive to it and contrary to the interests of the target company's shareholders.

The Court of Appeal reviewed a number of preceding decisions related to defensive tactics and directors' duties and further developed the *Teck* test. Unfortunately, the Court did not investigate the issue of the legality of adoption of the poison pill by the target company board and concentrated mostly on the directors' motives for using defensive tactics. It was once again confirmed that in spite of the conflict of interest situation, the directors must exercise their powers *bona fide* and in the best interests of the corporation. If the directors take certain actions, they should be able to show that their actions were reasonable in relation to the threat posed and were directed to the best interests of the corporation and its shareholders and were not motivated by an improper purpose of self-entrenchment. It was important that the Court pointed out the shareholders' right to decide to whom and at what price to trade their shares and required any defensive tactics to interfere with this right as little as possible. The Court also showed a preference to shareholder approval of defensive tactics, either prior to their adoption or subsequently. On the whole, defensive tactics that deprived target shareholders of the possibility to respond to a takeover bid were said to be unacceptable.

The 1994 case, *Rogers Communications Inc. v. Maclean Hunter Ltd.*,[276] also dealt with defensive measures in a takeover bid context. Rogers Communications Inc. ("Rogers") made a takeover bid for the shares of Maclean Hunter Ltd. ("Maclean"). The target directors contacted a number of parties interested in purchasing common shares or certain assets of Maclean in an attempt to maximize shareholder value and deter the Rogers bid. Maclean and prospective purchasers entered into confidentiality agreements which contained a "standstill" provision. This provision basically required the signatories to refrain from purchasing assets or securities of Maclean, or soliciting proxies from Maclean shareholders, until Maclean and a certain signatory enter into a binding agreement or for a stipulated period of time from the date of execution. A similar agreement was offered to Rogers. Under such agreement, Rogers would not be able to take up any shares of Maclean unless its bid constituted a permitted bid defined in the 1989 shareholder approved poison pill plan or was approved by the Maclean board. Access to confidential information concerning Maclean was conditioned to the signing of a confidentiality agreement with a standstill clause. Rogers applied for an oppression order. The application was dismissed as being premature and on the basis that Rogers was not oppressed as a shareholder, but rather as a bidder, and relief from the oppression of a bidder was not provided by law.

The decision raised several important issues. One of such issues concerned the discharge of directors' duties in a takeover bid situation. The Maclean board explained that the reason for their insisting on a standstill provision was to give time to other potential bidders to catch up with the initial bidder who had already completed its analysis and obtained the necessary financing. The Court agreed that this indeed might be beneficial for the target company and pointed out the importance of the target board

[276] 1994 CarswellOnt 1079, 2 C.C.L.S. 233, Ontario Court of Justice (General Division) (hereinafter, "*Rogers*").

not being passive in the face of a takeover bid. The principle that should be followed here was called "objective prospective reasonability."[277]

The Court also stated that a target board did not owe any duties towards a potential acquiror and, assuming the pro-discrimination position of certain American jurisdictions, noted that a self-appointed potential acquiror was not a protected species under corporate law. Such acquiror should be judged only on the basis of fairness of its offer, and deterring an unfair offer was entirely legitimate.

A number of important issues were raised in *CW Shareholdings Inc. v. WIC Western International Communications Ltd.*[278] Briefly, the facts of the case are as follows. CanWest Global Communications Corp. ("CanWest"), the largest holder of equity of WIC Western International Communications ("WIC"), announced a takeover bid for all WIC Class A voting and Class B non-voting shares at $39 per share. The WIC directors advised the shareholders to reject the offer and stated their intention to take steps to maximize shareholder value. They implemented a shareholder rights plan which was struck down by securities regulatory authorities.[279] A number of potential purchasers were identified which were given access to WIC confidential information subject to signing a confidentiality agreement with a "standstill" provision preventing such parties from acquiring WIC securities without prior approval of the WIC board. CanWest did not enter into such agreement and was consequently denied access to information. Soon after the shareholder rights plan was cease traded, Shaw Communications Inc. ("Shaw"), who owned 49.96% of WIC Class A voting shares, announced a takeover bid for all WIC Class B shares at $43.50 per share. In exchange for its offer Shaw required a pre-

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[277]A reference was made to *Paramount Communications Inc. v. QVC Network Inc.* 1994 Del. Lexis 57 (S.C.), where the Court said at p. 36: "If the board selected one of several reasonable alternatives, a court should not second-guess that choice even though it might have decided otherwise or subsequent events may have cast doubt on the board's determination."

[278]39 O.R. (3d) 755, [1998] O.J. No. 1886 (hereinafter, "*CW Shareholdings*").

[279]See Chapter IV, Section B above.

acquisition agreement providing a "break fee" of $30 million in case its bid was not successful and granting Shaw an irrevocable option to purchase WIC's radio assets. The above Shaw's offer and the pre-acquisition agreement was the subject of CanWest's complaint. CanWest argued that WIC directors acted contrary to their statutory and fiduciary duties and claimed relief under the oppression remedy.

Addressing the issue of the directors' duties, the Court noted the conflict of interest in which the directors usually found themselves in a takeover bid situation, the fiduciary duty to the shareholders, on the one hand, and a natural tendency to protect their own position of management and control, on the other hand. The usual mechanisms to be used by directors in such situations are the retainment of independent financial and legal advisors and establishment of independent or special directors' committee to assess and respond to a hostile bid. In the end, the directors must exercise their judgement and make a decision after a reasonable analysis of the situation and acting on a rational basis with reasonable grounds for believing that their actions will promote and maximize shareholder value. The Court noted that target directors should be left with as much flexibility as possible to deal with concrete circumstances and referred to the "business judgement rule" which operated to shield from court intervention business decisions which had been made honestly, prudently, in good faith and on reasonable grounds.[280] The directors' actions should be measured against the facts that existed at the time the decision was made, and the Court was reluctant to substitute its own opinion for that of the directors. Unlike the decision in *Producers Pipelines,*[281] the Court in *CW Shareholdings* did not consider that placing an onus of proof on the directors to

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[280]Deference to the business judgement exercised by a company's directors was further demonstrated in *Stern v. Imasco Ltd.*, 1 B.L.R. (3d) 198, 38 C.P.C. (4th) 347. The Court noted here that unless there are strong reasons, the Court would not interfere in the process of corporate decision-making. So long as the directors meet their legal duties to the corporation and its shareholders, the Court should not substitute its own business judgement.

[281]*Producers Pipelines, supra* note 272, at p. 595. It was said that the onus of proof was on the directors to demonstrate that their actions were reasonable in relation to the threat posed and were directed to the benefit of the corporation and its shareholders, and not for an improper purpose of their own entrenchment.

demonstrate the "entire fairness" of a transaction represented the law in Ontario on these matters and supported the "business judgement rule" approach. In the end, the Court held that the WIC directors complied with their statutory and fiduciary obligations and the oppression remedy was not granted.

Another notable 1998 case is *Pente Investment Management Ltd. v. Schneider Corp.*[282] In summary, the facts of the case are as follows. Schneider Corp. was effectively controlled by the Schneider Family (the "Family") through a two class structure of common shares and non-voting shares. In the event of an exclusionary offer a coattail provision was triggered and non-voting shares were to become voting. In 1988, the company filed an anti-conversion certificate to avoid this. In 1997, three takeover bids for the company's shares were announced. In their final offers, Maple Leaf offered $22 per share (combination of cash payment and share exchange), Smithfield offered $25 per share by share exchange, and Booth offered $25.50 cash per share. The Family, and subsequently the board of directors, decided to accept the Smithfield offer and entered into a lock-up agreement. Maple Leaf then sought to obtain control of Schneider Corp. without the support of the board or the Family. It claimed that its offer was exclusionary, so the Family's shares were converted into common and the Family lost its controlling interest. The Family argued that an anti-conversion certificate had been filed. Maple Leaf then raised its offer to $29 and claimed that the board's and the Family's actions were prejudicial to other shareholders. After proper consideration, the Court did not find oppression with respect to the Schneider Corp. shareholders, and the board's and the Family's actions were upheld.

One of the interesting questions raised in the *Schneider* decision was whether the Family, as a controlling shareholder, was obligated to accept the highest offer. The Court noted that the Family had an effective veto on any offer and was not obliged to sell to anyone. The Family did not have any fiduciary duties towards other shareholders and,

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[282][1998] O.J. No. 2036 (hereinafter, "*Schneider*").

respectively, did not have a commitment to maximize shareholder value or accept the highest offer. In evaluating the offers, aside from their financial value (which included not only the offer price, but also tax consequences), the Family also considered continuity of the company and the effect of any transaction on the company's other stakeholders, including shareholders, employees, suppliers and customers. As the Court put it, the Family had no obligation to be rational "in a dollar sense." They could just say "No" to any offer. The fact that they did not reject any offer from the beginning led the market to believe that the company was "in play" where in fact it was not. The Family was entitled to accept any offer that they considered corresponding to their requirements.

The issue whether the target company is really "in play" often arises in a takeover bid context[283]. In a number of cases it was held that the directors' duty to concentrate on maximizing shareholder value, the so-called "Revlon duty,"[284] arises only when the target company is in play. If, however, in the target company there is a veto block of shareholders who have a right to ignore or reject the offer and who have no intention of selling their shares under the bid, and the target company's directors are aware of such position, the company cannot really be considered in an auction mode.[285]

In *Schneider*, the Court found that the board did not breach its duties when it recommended to the shareholders to accept the Smithfield offer. As the board was aware of the Family's position, it understood that unless the Family agreed to trade to any bid, no bid would succeed. In fact, there was no unrestricted market auction for the Schneider Corp. shares. And if there is no unrestricted auction, if the company is not really "in play," the directors' duty to maximize shareholder value is only a subset of the best

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[283]*E.g., Benson v. Third Canadian General Investment Trust Ltd.* (1993), 14 O.R. (3d) 493, 13 B.L.R. (2d) 265 (Ont. Gen. Div.) (hereinafter, "*Benson*"); *Armstrong World Industries Inc. v. Arcand*, (1997), 36 B.L.R. (2d) 171.

[284]After *Revlon Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (1986).

[285]See *Benson*, at p. 273.

interests of the corporation for which the directors must have regard.[286] The Court found that the directors exercised their powers and discharged their duties honestly and in good faith with a view to the best interests of the company and that they exercised the care, diligence and skill that a reasonable and prudent person would exercise in comparable circumstances in a takeover bid situation. Taking into account the Family's position of a "gatekeeper" and its veto role, the directors recommended to the shareholders to accept the Smithfield offer and, actually, sell their shares at the highest reasonably available price, because other offers were simply not available under the circumstances.

Another case worthy of brief mention is *Gazit (1997) Inc. v. Centrefund Realty Corp.*[287] The takeover bid for the target company shares in this case triggered certain actions which very much amounted to defensive tactics, though they were not called such at the hearing. Briefly, the target company and its related groups of companies had agreements for advisory and property management services rendered to the target company. In the event of a change in control of the target company, it was contractually obligated to make substantial payments to its related companies for the above services. Moreover, an exchange of certain property was also provided. It was not disputed by anyone that the final offer under the takeover bid maximized the shareholder value, and the board recommended its acceptance. The bidder sought to restrain the completion of the above transactions on the basis that they favoured individually certain target directors who were also directors or shareholders of the companies rendering advisory and property management services. The respondents argued that all agreements and arrangements were in place and had been approved by the target shareholders prior to the bid and therefore, should not be set aside. The Court thoroughly reviewed the transactions in question, though not from the point of view of defensive tactics. In the end, it was held that the target board and its special committee complied with their duties to advance the shareholders' interests and exercised their reasonable business judgement. The Court

[286]Reference was made to *Benson*, p. 273 (B.L.R.).

[287][2000] O.J. No. 3070.

found no evidence of an improper motive behind the transactions in question, and the bidder's motion was dismissed.

The court practice with respect to defensive tactics adopted by target companies to deter takeover bids and duties of target companies' directors in such situations in not contradictory with the position of the securities regulatory authorities. Its primary concern is also the protection of the *bona fide* interests of target company shareholders. It is acknowledged that in a takeover bid context target directors find themselves in a conflict of interest position. Nevertheless, they must exercise their statutory and fiduciary obligations to act honestly and in good faith with a view to the best interests of the corporation, and in doing so, exercise care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. In the context of a hostile takeover bid, where the target corporation is in play (i.e. where it is apparent that there will be a sale of equity and/or voting contol), the duty of the directors is to act in the best interests of the shareholders as a whole and to take active and reasonable steps to maximize shareholder value by conducting an unrestricted auction in an open and even-handed way.[288] In discharging their obligations, target directors have sufficient freedom of actions, and the courts always deter to their business judgement, unless there is evidence to the contrary.

The courts never directly expressed their opinion whether the adoption of defensive tactics by target companies' boards of directors is in itself legal or not. It appears, however, that as long as target directors stand up to their duties, the courts do not object to their adoption of any defensive tactics. Nevertheless, it has always been stressed that the principal role of target directors is to provide information and advise and seek alternatives, and that the right to make the takeover bid decision should remain with the target shareholders.

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[288]See *CW Shareholdings*.

V. CONCLUSION

The underlying concept of the takeover bid regulation is that the rights of shareholders of companies that become the subject of takeover bids may be abused by bidders, and therefore such shareholders require special legislative and common law guarantees and protection. The legislation provides a number of means to minimize the risk to target shareholders. Extensive information should be made available to target shareholders with respect to the bid and the target company. Shareholders are guaranteed a certain period of time to deposit their shares under the bid, during which they can review all information, obtain professional advice, assess the bid, and take an informed decision with respect to the outstanding bid. All shareholders participating in a bid are guaranteed to receive equal price for their shares, even if the price was raised after they have deposited their shares. They are also guaranteed the right to withdraw their shares and sell them to another bidder if a competitive bid emerges. It appears that the legislation is carefully structured to achieve its proclaimed purposes and corresponds to its aims. However, in the author's respectful opinion, there are two issues that fall out of the coherent system. These two issues are identified below.

A. **Cap on Sale Premium**

Section 93(1)(c) of the OSA exempts from extensive takeover bid legislation requirements the bids where purchases are made from not more than five shareholders, the bid is not made to shareholders generally, and the consideration does not exceed the market price of the shares being sold by more than 15%. This provision, commonly referred to as the "private agreement" exemption, is one of the most controversial ones in the legislation, and has always been the subject of contradictory opinions.[289] The private agreement exemption was drafted as a compromise between those who would entirely

[289]For a summary of discussions, see F. Calandriello, *The Sale-of-Control Premium*, in *Corporate Structure, Finance and Operations*, v. 5 (Toronto: Carswell, 1988), pp. 213-242.

eliminate it and those who would expand it, and has always been the subject of many disputes.

This issue was brought up in the Hodgson Report. The question was whether the private agreement exemption should be preserved or deleted. The Select Committee did not come to a unanimous conclusion whose interests should be protected, the ones of the selling shareholder or of the remaining shareholders. Nevertheless, the majority of the Select Committee favoured the exemption. The majority of the members of the Select Committee argued that shares were a form of personal property, and the owner should be entitled to dispose of them on whatever terms he might consider advisable without interference on the part of the legislature. The freedom of the controlling shareholder should not be diminished unless there are cogent and overriding reasons for so doing. Abolishing the private agreement exemption would reduce incentives for developing and managing a business by denying the controlling shareholder a well merited premium for his efforts. Finally, imposition of a requirement of a general offer could result in economic hardships for the prospective purchaser and might deter the bid.[290] The minority argued that each share in the capital of a company was the same as every other share of the same class and entitled the holder to an aliquot interest in the company. They were of the opinion that control was a corporate asset and belonged to all shareholders, thus, any premium should be shares by all shareholders.[291] In spite of the arguments of the majority of the Select Committee, it was the view of the minority that became the law at that time.

The Industry Report vigorously opposed the position that an opportunity to sell a controlling interest in a public company at a premium without any offer being made to other shareholders conformed to traditional views on property rights, and the ability to capture such a premium was a reward for entrepreneurship, and called this position

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[290] Hodgson Report, pp. 28 - 33.

[291] *Ibid.*

"unsupportable."[292] Its view was based on economic reasons. The following reasoning was used in the Industry Report. Benefits were obtained by redeploying the target company's resources. Formal offers invited competition and thus enhanced the allocational process. Private agreement transactions would deny to the capital market the advantages of an auction process. The Industry Report even went on to say that permitting the sale of a block of shares at a special price was tantamount to having two types of shares within the same class of shares.[293]

The fairness reasons were also pointed out in the Practitioners Report. The report stressed the "legislative objective of making control premiums available to all shareholders of a public issuer" and pointed to the "legislated equality of treatment among all shareholders."[294]

There is enough authority to support either point of view. However, it is the author's respectful opinion that there is not sufficient evidence to justify the imposition of a legislative cap on the sale premium.

A principal justification for requiring equal participation of all shareholders in the sale premium is that holders of shares of the same class should enjoy equal rights and opportunities.[295] This can also be inferred from the provisions of the OBCA[296] and

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[292]Industry Report, p. 26.

[293]*Ibid*, pp. 30-37.

[294]Practitioners Report, para. 2.03.

[295]The case law on this subject varies a lot. See Wishart, *supra* note 248, at pp. 111-128. However, the recent point of view in Ontario appears to be expressed in *Re Canadian Pacific Ltd.* (1996), 30 O.R. (3d) 110 (Ont. Gen. Div.), where at pp. 125-126 it was stated: "While shareholders within the same class of shareholders must be dealt with proportionately and equally, it is not accurate to say that all shareholders as between classes must be treated the same, proportionately or equally." Therefore, it looks like an accepted position that within the same class of shares, all shareholders must be treated equally.

[296]OBCA s. 22(6): "... each share of a class shall be the same in all respects as every other share of that class."

indirectly, CBCA.[297] When a person purchases certain shares, he is guaranteed certain rights attaching to such shares. Such rights may include, depending on the class of shares, the right to vote at meetings of shareholders, the right to receive dividends, the right to receive the remaining property of the corporation on dissolution, or other rights guaranteed by law or outlined in the corporation's by-laws. However, to the best of the author's knowledge, no by-laws or articles, not to mention any law, ever guaranteed to a shareholder that he would be able to sell his shares at the highest possible price or on particular conditions. These are not integral rights attached to shares, and there is no valid reason why the courts or the securities law should go further than the corporate law and corporate documents and attach additional rights to shares.

Speaking of economic justification, the following arguments can be made. It is widely acknowledged that takeovers lead to a more efficient allocation of resources and are beneficial for all parties. They are also beneficial for the target shareholders because the purchaser, presumably, will make a more efficient use of the company's assets, and the benefits to target shareholders will increase. However, these benefits are denied when a purchaser acquires shares under a private agreement. If the purchaser is willing to pay a price higher than the market one, he, presumably, is hoping to obtain certain synergistic or other gains that will justify the price that he has paid. The efficient capital market is expected to respond accordingly, and the shares' price is supposed to rise, ultimately benefiting the target shareholders. Imposing an obligation on the purchaser to make a general offer simply increases the cost of the acquisition, and proportionately decreases gains to target shareholders.[298]

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[297]CBCA s. 24(4)(a): "... the rights, privileges, restrictions and conditions attaching to the shares of each class shall be set out [in the articles]."

[298]See F.H. Easterbrook and D.R. Fischel, "Corporate Control Transactions" *(1982) 91 Yale L.J. 698,* at p. 705: "The sale of a control block of stock, for example, allows the buyer to install his own management team, producing the same gains available from a tender offer for a majority of shares but at a lower cost to the buyer. Because such a buyer believes he can manage the assets of a firm mor profitably, he is willing to pay a premium over the market price to acquire control... If there were no anticipated increase in value, it would be irrational for the buyer to pay the premium. There is a strong presumption, therefore, that free transferability of corporate control... moves assets to higher valued uses... Although the purchaser benefits if the share prices of the target firm appreciate after the transfer in control, this gain

As well, a particular characteristic of Canadian corporations is that the vast majority of publicly traded corporations have a controlling shareholder, and most control transfers are consensual. Rules that alter the distribution of control premiums do not advance the economic goals of rationalizing asset use, creating synergies and disciplining corporate management. Restricting a premium that can be captured by a selling controlling shareholder, either by forcing the controlling shareholder to share the premium with minority shareholders or forcing the acquiror to make an offer to all shareholders, might induce some controllers not to sell and some offerors not to buy. Because of the vital importance of control changes, rules that mandate equality of treatment are likely to prove costly to the Canadian economy.[299]

Another argument put forward by proponents of equal participation in the sale premium was that a controlling shareholder owed fiduciary duties to minority shareholders.[300] Recent court decisions show that this is no longer a plausible argument by holding that no fiduciary duties are imposed on a majority shareholder towards minority shareholders.[301]

Moreover, the 15% cap seems absolutely arbitrary. Would it be true to say that if a controlling shareholder sells his shares at a 14% premium over the market price, this is not detrimental to the remaining shareholders, and if he sells at a 16% premium, it

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accrues equally to shareholders who did not sell to the purchaser."

[299] J.G. MacIntosh, "The Canadian Securities Administrators Takeover Proposals: Old Wine in Old Bottles?" *(1993) 22 Can. Bus. L. J. 231*, pp. 234 - 247.

[300] *E.g.*, R.W.V. Dickerson, J.L. Howard & L. Getz, *Proposals for a New Business Corporations Law for Canada* (Ottawa: Information Canada, 1971), para. 487: "... dominant shareholders, who are in a position to control management, owe a fiduciary duty to minority shareholders comparable to the duty that directors and officers owe to the corporation." See also *The New Rules for Continuous Disclosure: Take-Over Bids: Insider Trading and Civil Liability*, Lectures/Edited Panel Discussions from the programme held in May, 1978, LSUC.

[301] *E.g., Brant Investments Ltd. v. KeepRite Inc.* (1991), 3 O.R. (3d) 289, 80 D.L.R. (4th) 161 (C.A.), *Benson v. Third Canadian General Investment Trust Ltd.* (1993), 14 O.R. (3rd) 493, O.J. No. 1491, *Pente Investment Management Ltd. v. Schneider Corp.* [1998] O.J. No. 2036.

instantly becomes detrimental? Of course, not. The issue whether the sale of his block of shares by a controlling shareholder is prejudicial to the remaining shareholders should be decided individually in each case, taking into consideration all circumstances of the case, including the intentions of the purchaser.

In the author's opinion, the current provision in s. 93(1)(c) does not guarantee the protection to target shareholders in the way it is proclaimed to. In some situations, it may be excessive, in others not sufficient. It is still possible for a controlling shareholder to sell his block of shares under a private agreement, though, probably, with a less premium than he would otherwise receive. A purchaser motivated by looting or other improper purposes is still able to obtain control of a company without making a general offer to all shareholders. A lot of various circumstances should be taken into consideration to determine whether the interests of target shareholders are prejudiced, whether they require protection, whether there are enough reasons to justify judicial intervention, and what particular measures should be taken. If certain target shareholders feel that their interests are being abused, they can always turn to the oppression remedy. Courts are best suited to achieve the goal of providing adequate protection to target shareholders in each particular case.

B. Shareholder Rights Plans

Another important issue that is not consistent with the "legislated equality of treatment among all shareholders"[302] is whether boards of directors should be permitted to adopt shareholder rights plans. Typically, after a shareholder rights plan is adopted, but before it is activated, all shareholders have equal rights to purchase additional shares of the company, usually at a discount price, when a triggering event, usually a takeover bid, occurs. When, however, the plan comes into effect, and one of the shareholders announces a takeover bid for the company's shares, this shareholder is precluded from

[302]Practitioners Report, para. 2.03.

exercising the rights which are attached to his shares pursuant to corporate documents. There seems to be no rational explanation for such discrimination.

As it was demonstrated previously, there appears to be enough evidence to support the position that equal treatment of shares is inherent in the common law. The issue dates back to the late 19th century and two English cases, *Oakbank Oil Company v. Crum*[303] and *Birch v. Cropper,*[304] where the principle that rights attach to shares, and not to shareholders, was first underlined.[305] This principle was further confirmed in a number of Canadian cases, including *Bowater Canadian Ltd. v. R.L. Crain Inc.*[306] and *The Queen v. McClurg.*[307] *Bowater* is said to stand for the proposition that the rights of a given class of shares must be equal in all respects (subject to the separate rights that may be assigned to series within a class of shares) or even for a broader proposition that all shareholders of a class of shares must be treated equally.[308] *McClurg* also supports the position that a precondition to the derogation from the presumption of equality with respect to various shareholder entitlements is the division of shares into different classes.[309]

Taking into consideration the relevant legislative provisions of the OBCA and CBCA[310] and court decisions, it appears that it is a long established principle of Canadian common law that any rights associated with shares should attach to shares and not to shareholders, and there should be no discrimination among holders of the same class of

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[303][1883] 8 A.C. 65 (H.L.)

[304][1889] 14 A.C. 525 (H.L.)

[305]See Wishart, *supra* note 248, pp. 111-112.

[306](1987), 62 O.R. (2d) 752 (Ont. C.A.) (hereinafter, "*Bowater*").

[307][1990] 3 S.C.R. 1020, (1990) 76 D.L.R. (4th) 217 (hereinafter, "*McClurg*").

[308]F.H. Buckley, M.R. Gillen & R. Yalden, *Corporations* (Toronto: Emond Montgomery Publications Limited, 1995), at p. 410.

[309]*McClurg*, at p. 1041-1042.

[310]*Supra* notes 296 and 297.

shares. There is no legal basis to justify the derogation from this principle and for holding that under particular circumstances certain shareholders may be deprived of any of their rights. Unlike the right to participate in a sale premium, the right to purchase additional shares of the company under certain conditions is usually expressly stated in the company's by-laws and a holder of a company's share knows that his shares bear such a right. Unfortunately, the courts seem reluctant to consider whether the adoption of shareholder rights plans is legal under Canadian legal regime and concentrate more on motives and purposes of directors for adoption of such plans, which is a secondary issue. In the author's opinion, it should be clearly pronounced by courts that the principle of equality of shareholders of the same class is mandatory in Canada, every shareholder is entitled to exercise the rights attached to his shares, and companies cannot contract out of it.

C. **Summary Conclusion**

The Canadian takeover bid legislation is primarily aimed at protecting shareholders of target companies. It provides a number of guarantees to ensure that target shareholders are not under undue pressure in the face of a takeover bid. The law provides the target shareholders with an opportunity to thoroughly assess the outstanding bid and take a reasoned informed decision about trading their shares under the bid. The law also requires that directors of target companies act honestly and in good faith with a view to the best interests of the shareholders. There are, however, issues, that, in the author's opinion, are not consistent with the carefully structured system. These issues are (i) the restriction on free transferability of shares, and (ii) the adoption by boards of directors of shareholder rights plans. The restriction on free transferability of shares places the seller and the purchaser at a disadvantage incompatible with free market enterprise and, at the same time, fails to achieve the purpose of the legislation. The above restriction does not in any way provide protection to target shareholders from bidders with improper motives and does not serve any useful purpose. As for the second issue, absence of the courts' objection to the boards of directors' adopting discriminative tactics with respect to any shareholders, which in essence means permission of adoption of such discriminative tactics, is contrary to the long established common law principle of equality of treatment of shareholders of the same class. It should be clearly stated by courts that rights attach to shares and not to shareholders, and any derogations from this principle, irrespective of the motive for such derogation, should not be permitted.

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