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Constraints and Obligations Relating to the Sale of Corporate Control: The Canadian Approach

Bruce Bailey* and H. Purdy Crawford**

I. INTRODUCTION

Canadian jurisprudence has generally held, as a matter of corporate law, that majority shareholders and directors of a public corporation owe no duty, fiduciary or otherwise, toward minority shareholders simply because they have either sold or sanctioned the sale of a controlling block of shares¹ at a premium not available to the other shareholders.² In

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Author's note: This paper was written in 1985. Since the date of writing the proposed legislative reforms outlined in Part V of this paper have generally been implemented. See Ontario's revised takeover provisions in *An Act to Amend the Securities Act*, S.O. 1987, c. 7 and Quebec's takeover amendments in *An Act to Amend Various Legislative Provisions Respecting Securities*, S.O. 1987, c. 40.

¹ The reference to the sale of a controlling block of shares implies that the sale of corporate control issue concerns only voting shares. Under the theory that control is a corporate asset and, to a lesser extent, under the theory that majority shareholders have a fiduciary duty to minority shareholders, the sharing of a control premium should not be limited to voting shareholders. The Ontario follow-up offer obligation currently applies only to voting shares. Under a recent policy of the Ontario Securities Commission [hereinafter "O.S.C."], however, holders of nonvoting shares would be entitled to be treated in the same manner as holders of voting shares where a takeover bid was made for such nonvoting shares. Under the revisions to the *Securities Act, 1982* (Quebec), this matter is regulated as a legislative provision. See *infra*, sections V and VI.

² See F. Iacobucci, M. Pilkington, and J.R. Pritchard, *Canadian Business Corporations* (Agin-court, Ont.: Canada Law Book, 1977) at 293-96; S. BECK *et al.*, *Business Associations Casebook* (Toronto: De Boo, 1979) at 356-91; see also *Short v. Treasury Commissioners* (1948), [1948] A.C. 534 (H.L.). As dictum, Lord Uhwatt states:

[I]f some one shareholder held a number of shares sufficient to carry control of the company, it might well be that the value proper [sic] to be attributed to his holding . . . was greater than the sum of values that would be attributed to the shares comprised in that holding if they were split between various persons. The reason is that he has something to sell—control—which the others considered separately have not.

Ibid. at 546. But see Gower *et al.*, *Gower's Principles of Modern Company Law*, 4th ed. (London: Stevens, 1979) 707. Gower does state, however, that "[w]e may, indeed, be approaching the view taken by a number of American courts, that members who sell shares which confer effective control of the company and, in consequence, command a higher price are under a duty to share the excess price with the other shareholders." *Ibid.* at 640.

There has only been a limited recognition of a fiduciary duty of the majority to the minority

1965, a seminal study of securities legislation, the Report of the Attorney General's Committee on Securities Legislation in Ontario, recommended that the right of minority shareholders to share in a control premium paid to majority shareholders should be left to development by the judicial process.³ Since there was no subsequent judicial development providing minority shareholders with an opportunity to share in a premium paid for corporate control,⁴ the issue of such an equal opportunity was, after considerable debate, addressed in the 1978 *Ontario Securities Act*,⁵

shareholders were corporate control is sold. See *Farnham v. Fingold*, (1972), 29 D.L.R. (3d) 279, [1972] 3 O.R. 688 (H.C.); rev'd on other grounds (1973), 33 D.L.R. (3d) 156, [1973] 2 O.R. 132 (C.A.) (recognition, as a legitimate cause of action for consideration on the merits, of a suit predicated on the existence of a fiduciary obligation owed to all shareholders by a control group in the sale of their controlling shares at a premium in an interlocutory proceeding settled before trial; the issue before the Court of Appeal dealt simply with whether there was a proper class action); see also *Re R.J. Jowsey Mining Co. Ltd.* (1969), 6 D.L.R. (3d) 97, [1969] 2 O.R. 549 (C.A.). In addition, J. Laskin states that "the taking of control of a public company itself lays a burden of fair dealing on the person or group who secures it, beyond any duty that devolves upon them as directors in the day to day operations of the company." *Ibid.* at 556-57. In *Re Consolidated Manitoba Mines, Ltd.* (1966), [1966] O.S.C. Bull. 5, the O.S.C. observed that the question of sharing a control premium was a matter of corporate law, but intervened by refusing to allow a transfer of shares within escrow where the transfer would pass control to purchasers without a takeover bid being made for the minority shares. The court stated:

[A]s to a shareholder's right to equal opportunity, the Ontario law may not be settled on this question but it is recognized as good corporate practice to provide this. . . . Indeed it is just because the law is not clear that the Commission feels impelled . . . to extend its protection to the shareholders. . . . [I]n so doing the Commission is trying to carry out the spirit of the law.

Ibid. at 10.

The oppression remedies of the *Canada Business Corporation Act*, S.C. 1974-75-76, c. 33, s. 234 [hereinafter "CBCA"] and the similar provisions enacted elsewhere in Canada (for example, *Business Corporations Act*, S.A. 1981, c. B-15, s. 234; *Company Act*, R.S.B.C. 1979, c. 59, s. 224; *The Corporations Act*, S.M. 1976, c. 40, s. 234; *Business Corporations Act*, S.N.B. 1981, c. B-9.1, ss. 166-67), give shareholders and other parties the right to take action against the corporation or its directors if any act of the corporation or the conduct of its business or the exercise of power of the directors is oppressive, unfairly prejudicial, or unfairly disregards the interest of any security holder, creditor, director, or officer. Under this section, the court is given a broad remedial power, including the power to make a restraining order, an order for compensation, as well as any interim order it sees fit.

The substantive provisions of the oppression remedy are broad and general. Its future application to cases of sale of corporate control will be contingent upon the development of case law extending the protection of the provision to such cases. The section has received consideration in a number of cases over the last few years. It has not, however, been applied to cases of sale of control. One is inclined to wonder whether the obstacles preventing success in common law actions by shareholders for an accounting with respect to premiums paid to the majority for the sale of control will also stand as obstacles to the use of the statutory provisions for such purposes—the obstacle being the absence of a generally accepted legal principle, as a matter of corporate law, regulating the sale of control. The question thus becomes whether the substantive provisions of the oppression remedy create a duty where none existed before.

³ *Report of the Attorney General's Committee on Securities Legislation in Ontario*, 1965, 23 at para. 3.12 ("Kimber Report").

⁴ Indeed, there has been no judicial development subsequent to 1978 providing for a sharing of a control premium in Canadian jurisprudence.

⁵ *Securities Act*, 1978, S.O. 1978, c. 47, as am. S.O. 1979, c. 86 and R.S.O. 1980, c. 466 [herein-

which enacted a shareholder equal opportunity law commonly known as the "follow-up offer obligation."⁶

In general terms, the *Act* requires that a purchaser who acquires publicly traded voting shares of a public corporation in a private agreement transaction, which would normally be regulated by the *Act* as a takeover bid, paying a price exceeding 15% of the trading price must make a follow-up offer of equivalent value to the remaining shareholders.⁷

The other Canadian provinces did not enact an equal opportunity rule except Quebec which adopted such a rule in 1982. In Quebec, the rule removes the private agreement exemption where the offeror pays in excess of a 15% premium over the trading price, requiring all bids at that premium to be made pro rata.⁸

After six years of experience with the follow-up offer obligation, which gave rise to considerable difficulties in its applications,⁹ the securities administrators of Alberta,¹⁰ British Columbia,¹¹ Ontario, Quebec, and the Director under the *Canada Business Corporations Act*¹² have apparently come to a consensus on the sale of control issue. Ontario would remove the follow-up offer obligation from the *Act* and the administrators from the various provinces will recommend that their respective leg-

after "*Act*"). The regulation under the *Act* is R.R.O. 1980, Reg. 910, as am. by O. Reg. 84/81, O. Reg. 224/81, O. Reg. 238/81, O. Reg. 637/82, O. Reg. 649/82, O. Reg. 808/82, O. Reg. 180/83, O. Reg. 205/84, and O. Reg. 286/84 [hereinafter "regulations"].

⁶ See generally 2 V. Alboini, *Securities Law and Practice* (Toronto: Carswell, 1984) at 19-70 to -93; P. Anisman, *Takeover Bid Legislation in Canada: A Comparative Analysis* (Don Mills, Ont.: CCH Canadian, 1974) at 37-44; D. L. Johnston, *Canadian Securities Regulation* (Toronto: Buttersworth, 1977) at 324, 340-41; D. L. Johnston et al., *Canadian Securities Regulation Supplement* (Toronto: Buttersworth, 1982) at 46, 53; Bailey & Crawford, "The Take-over Bid by Private Agreement: The Follow-up Offer Obligation" (1983) 7 *Dalhousie L.J.* 93.

⁷ See *Act*, *supra*, note 5 at s. 91(1); see also *infra*, Part III.A.

⁸ *Securities Act*, 1982, S.Q. 1982, c. 48, s. 116 [hereinafter "*Quebec Act*"]; Q. Reg. 83-660, s. 187; see *infra*, Sections III.B & V for further discussion of the *Quebec Act* and recent legislative reforms.

⁹ See *infra*, Part IV and Bailey & Crawford, *supra*, note 6 at 128.

¹⁰ Alberta currently has no equal opportunity rule with respect to the sale of control. *Securities Act*, S.A. 1981, c. S-6.1, as am. by S.A. 1982, c. 32 and S.A. 1984, c. 64 (not proclaimed).

¹¹ British Columbia currently does not have an equal opportunity rule in its securities legislation. *Securities Act*, R.S.B.C. 1979, c. 380. A draft proposal for new securities legislation in 1982 did, however, include the follow-up offer obligation. See British Columbia, Ministry of Consumer and Corporate Affairs, *A Proposed New Securities Act and Draft Regulations* (Victoria: Ministry of Consumer and Corporate Affairs, 1982) at para. 137. British Columbia has, however, introduced a bill to amend its securities legislation in accordance with the consensus among the securities administrators. See *infra*, note 89.

¹² There may be a question whether the Parliament of Canada has the constitutional authority to enact an equal opportunity rule in the *CBCA*. Since the provisions in the *CBCA* relating to takeover bids are only operative when the target corporation is a *CBCA* corporation, we believe that such an amendment to the *CBCA* would be *intra vires* the Parliament of Canada. See *Esso Standard (Inter-America) Inc. v. J.W. Enterprises Inc.* (1963), [1963] S.C.R. 144; *Rathie v. Montreal Trust Co.* (1953), [1953] 2 S.C.R. 204; *Re a Reference Concerning the Constitutional Validity of Section 110 of the Dominion Companies Act* (1934), [1934] S.C.R. 653.

islatures enact provisions whereby the private agreement exemption would be available only where the purchase price does not contain a premium in excess of 15% of the trading price, essentially in accordance with the scheme adopted by Quebec.¹³

II. PROS AND CONS RELATING TO THE SALE OF CONTROL PREMIUM

Economists and legal commentators who oppose the regulation of private acquisitions of control essentially argue that shares are a form of private property which should be freely transferable without regulatory restraints to protect minority shareholders. The theoretical rationale of those who support this point of view is that economic efficiency will be facilitated if there are no regulatory restraints, since corporate control transactions are beneficial not only to the corporation but also to the economy in general.¹⁴ It is argued that transfers of control, which are prima facie deemed desirable, might not take place if there was a rule providing for sharing a control premium. Such sharing would increase the cost of the acquisition of control, thereby reducing the purchaser's incentive to buy or lower the premium paid to the controlling shareholder, thereby reducing the controller's incentive to sell.¹⁵ Posner states

¹³ See *infra*, Part V. Manitoba adopted the follow-up offer obligation in its securities legislation which has not yet been proclaimed in force. *Securities Act, 1980*, S.M. 1980, c. 50, s. 91(1). Presumably, Manitoba will eventually adopt the new regime.

¹⁴ Thus, Jensen states:

The take-over market . . . provides a unique, powerful and personal mechanism to accomplish the major restructuring and redeployment of assets continually required by changes in technology and consumer preferences. Recent changes occurring in the oil industry provide a good example . . . scientific evidence indicates that activities in the market for corporate control almost uniformly increase efficiency and shareholders' wealth.

M.C. Jensen, "Take-Overs, Folklore and Science" [Nov.-Dec. 1984] *Harv. Bus. Rev.* 109 at 119. See also Jensen & Ruback, "The Market for Corporate Control: The Scientific Evidence" (1983) 11 *J. Fin. Econ.* 5 (the authors argue that the evidence indicates that corporate takeovers generate positive gains, that target firm shareholders benefit, and that bidding firms' shareholders do not lose); P. Halpern, "Corporate Acquisitions: A Theory of Special Cases? A Review of Event Studies Applied to Acquisitions" (1983) 38 *J. Fin.* 297:

The last set of value maximization acquisition motivations is based on the attempt by the acquiror to obtain control of the target. In its most general form the acquiring firm desires control to replace an incompetent management or to force existing management to follow a profit maximizing strategy. Under either scenario it is expected that the shareholders of the target firms would be earning below normal returns in some period preceding the acquisition.

Ibid. at 300. See generally R. Posner, *Economic Analysis of Law*, 3rd ed. (Boston: Little, Brown, 1986) at 385-88; F.H. Easterbrook & D.R. Fischel, "Corporate Control Transactions" (1982) 91 *Yale L.J.* 698 at 716; F. H. Easterbrook & D.R. Fischel, "Takeover Bids, Defensive Tactics, and Shareholders' Welfare" (1981) 36 *Bus. Law.* 1733; 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 (resistance by corporation's Managers to premium tender offers ultimately decreases shareholder welfare); 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.

¹⁵ Easterbrook and Jarrell argue that regulation increases the cost of making offers so that

that a rule circumscribing a controller's right to a premium would injure rather than benefit minority shareholders because, "by reducing the controlling shareholder's incentive to sell his control [the rule] retards the reallocation of the assets of the corporation to people who can use them more productively, to the benefit of all of the shareholders."¹⁶ Easterbrook and Fischel share Posner's view that sales of control will ultimately benefit shareholders and the economy in general by, among other things, facilitating the infusion of better management into moribund corporations. A requirement for a pro rata offer to all shareholders would, they argue, likely preclude some beneficial transactions from taking place:

The sale of a control block of shares . . . 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 lower cost to the buyer. Because such a buyer believes he can manage the assets of a firm more profitably, he is willing to pay a premium over the market price to acquire control. The premium will be some percentage of the anticipated increase in value once the transfer of control is effectuated. . . . There is a strong presumption, therefore, that free transferability of corporate control, like any other type of voluntary exchange, moves assets to higher valued uses.¹⁷

The assumption that sales of control at a premium will in general be beneficial to the remaining shareholders may be open to question; we are unaware of any studies or empirical data to support the assumption and Easterbrook and Fischel do not refer to conclusive scientific data in support of their arguments.¹⁸ Indeed, Ronen's theoretical economic analysis

fewer offers will be made. See *Advisory Committee on Tender Offers Report of Recommendations* (Washington, D.C.; SEC, 8 July 1983) at 70 (Easterbrook and Jarrell, dissenting) [hereinafter "SEC Advisory Committee Report"]; see also, e.g., G. B. Javaras, "Equal Opportunity in the Sale of Controlling Shares: A Reply to Professor Andrews" (1965) 32 U. Chi. L. Rev. 420; Comment, "Sales of Corporate Control and the Theory of Overkill" (1965) 31 U. Chi. L. Rev. 725 at 751.

¹⁶ R. Posner, *supra*, note 14 at 386.

¹⁷ Easterbrook & Fischel, *supra*, note 14 at 705. In response to recommendation 14 of the SEC Advisory Committee Report, see *supra*, note 15 and *infra*, note 37, which recommended a limit of 20% for the holdings of any person in a public corporation unless further shares were acquired from the issuer or through a tender offer, Easterbrook and Jarrell stated that the:

[t]ender-offer-or-nothing rule of recommendation 14 would have substantial costs. It would make assembly of a moderate size minority block . . . more difficult by compelling the purchaser to use an expensive tender offer in place of open market purchases. . . . If the assembly of such blocks is made more costly, we can be confident that fewer blocks will be assembled.

Second, making the open market assembly of blocks more costly also makes tender offers more costly. Bidders will have to start with smaller blocks of shares if they seek control. Anything that makes acquisitions more costly means that there will be fewer acquisitions.

SEC Advisory Committee Report, *supra*, note 5 at 22-23.

¹⁸ See R.W. Hamilton, "Private Sale of Control Transactions: Where We Stand Today" (1988) 13 Can.-U.S. L.J. 229 at 237 (stating that "I do not view hypothetical examples, such as those put forth by Easterbrook and Fischel, to prove anything more than there *may be* idealized situations

of sale of control transactions indicates that private sales of control are as likely to be harmful to the remaining shareholders as they are to be beneficial.¹⁹ Some commentators have also noted that the assumption of benefits ignores the fact that many takeovers occur not because the target corporation is badly operated, but because it is an efficient and well-run corporation which may be undervalued due to prevailing economic conditions.²⁰ In addition, based upon our own experience, it is difficult to justify some takeovers purely on economic grounds. Some takeovers have been the civilized equivalent of war in the private sector, and gamesmanship and power have been important elements. Furthermore, as Leech argues, economic evidence has not been provided to show that a requirement of a sharing of the control premium would unduly impede the takeover bid technique.²¹

Easterbrook and Fischel recognize that risk adverse investors may

where everyone is better off as a result of the transfer of control; they do not prove that there are such situations, or their frequency"). Hamilton does, however, conclude that the absence of a general rule requiring a sharing of the control premium has probably facilitated economic efficiency in the United States. The authors have had the benefit of reading a draft of Professor Hamilton's paper prior to writing this paper.

¹⁹ J. Ronen, "The Sale of Controlling Interest: A Financial Economic Analysis of the Governing Law in the United States and Canada" (1985) 13 Can.-U.S. L.J. 263. Notwithstanding such potential for harm, Ronen concurs with Easterbrook and Fischel that there should be no requirement for a sharing of a control premium:

[M]y analysis indicates that sales of control are not necessarily beneficial to noncontrolling shareholders. Nonetheless, sale at a premium should be lawful without spreading the bounty because, ex ante, under the scenario I depicted (risk-neutral noncontrolling shareholders, along with the seller, are ignorant about the nature of the purchasers and perceive a distribution of looting potential that is symmetric [with looting] under the incumbents), the purchaser is just as likely to be an overlooter. . . as he is to be an underlooter. . . . The sale should be lawful even when noncontrolling shareholders are harmed ex post. The main point is that, ex ante, they are as well off in terms of expected utility and either the seller or purchaser is strictly better off and the other is at least as well off.

Ibid. at 281 (footnote included). Ronen concludes that the rule of American case law that a controller should not have to share a premium with other shareholders is, with some exceptions, economically efficient, but the dominant shareholder should be held liable for damages caused by consequential looting of a purchaser. *Ibid.* at 298. The authors have had the benefit of reading a draft of Professor Ronen's paper prior to writing this paper.

²⁰ D.J. Block & N. Schwarzfeld, "Curbing the Unregulated Tender Offer" (1978) 6 Sec. Reg. L.J. 133 at 135.

²¹ N. Leech, "Transactions in Corporate Control" (1956) 104 U. Pa. L. Rev. 725 at 838. Certainly, the follow-up offer obligation does not appear to have unduly impeded takeover bids in Ontario or Canada. See also V. Brudney, "Fiduciary Ideology in Transactions Affecting Corporate Control" (1966) 65 Mich. L. Rev. 259, who states that:

Certainly before diluting [fiduciary standards] as substantially as has been suggested, some imperative need for allowing a controlling stockholder to sell at a premium should be shown, or some empirical evidence should be offered to establish that controlling groups are likely to sell out more readily to economically desirable purchasers if they are permitted to receive a premium, or that there is some over-all social or economic need so to encourage transfers of control of publicly held corporations. No such evidence has been offered, nor has such a need been demonstrated.

Ibid. at 299.

prefer sharing the premium on a sale of corporate control as compared to taking the risk that the new corporate controller will increase the value of his investment in the corporation. They suggest, however, that the risk of loss in sale of control transactions may be protected by either portfolio diversification or by refraining from investing in firms that are privately or closely held or controlled by any person.²² However, diversification may be a practical problem involving substantial cost to shareholders, especially if a shareholder has a desire to invest in a particular industry which may limit choice. Investment diversification appears particularly difficult in Canada where there are fewer widely held corporations in which to invest than in the United States. At least from a Canadian perspective, we are not persuaded by the argument that a sale of control transaction is not harmful because an investor could have refrained from making the investment.²³

Proponents of a rule mandating a sharing of a control premium have generally argued either: (1) control is a corporate asset so that payment of a premium should be shared with all shareholders;²⁴ (2) by virtue of the majority shareholders' ability to dominate the affairs of the corporation through the election of directors and their direction over management, and assets of the corporation, the majority shareholder is placed in a custodial relationship vis-à-vis the minority, and has a fiduciary duty of loyalty to ensure that the minority is treated equally when corporate control is sold;²⁵ or (3) a premium should be shared by all shareholders essentially on fairness considerations.²⁶

Bebchuk argues in favour of equal treatment of shareholders and the sharing of a control premium among all shareholders for fairness considerations, stating: "It is a widely held principle that, absent any reason to the contrary, individuals in like situations should be treated alike. . . . The presumption is rooted in a view that individuals are equal in some

²² Easterbrook & Fischel, "Corporate Control Transactions," *supra*, note 14 at 712, 714; see also Ronen, *supra*, note 19 at 31; Easterbrook & Jarrell, *supra*, note 15 at 82-83 (stating that "[s]elf-protection is simple. The small, risk-averse shareholder may simply sell his shares on the market—getting the enhanced price available in a world of easy takeovers—and buy something else. . . . [T]he other option is to buy a mutual fund or some other diversified portfolio").

²³ Hamilton concurs: "[I]t is not very persuasive to argue that certain . . . transactions are not harmful because persons who are likely to be injured by them may in some limited subclasses of those transactions insure or protect against that injury through diversification of investment or by not making certain investments in the first place." Hamilton, *supra*, note 18 at 238.

²⁴ See generally A. Berle & G. Means, *The Modern Corporation and Private Property*, rev. ed. (New York: Harcourt, Brace, 1968) at 216-17; A. Berle, "The Price of Power: Sale of Corporate Control" (1965) 50 Cornell L.Q. 628 at 638.

²⁵ See generally D. C. Bayne, "Corporate Control as a Strict Trustee" (1965) 53 Geo. L.J. 543; see also Brudney, *supra*, note 21 at 296-97; R.W. Jennings, "Trading in Corporate Control" (1956) 44 Calif. L. Rev. 1.

²⁶ W. D. Andrews, "The Stockholder's Right to Equal Opportunity in the Sale of Shares" (1965) 78 Harv. L. Rev. 505. Andrews rejected the corporate asset theory due to its "operative difficulties," and instead proposed a prophylactic rule of equal opportunity. *Ibid.* at 512-13. See also Bailey & Crawford, *supra*, note 6 at 108.

fundamental sense and that claims for natural superiority must be rejected.”

If the target were to remain independent, the two shareholders would be entitled to the same fraction of the target’s distributed earnings. Thus, unless we can identify either a morally relevant feature to distinguish between these two shareholders, or some adequate reason for refuting the presumption of equality in the considered context, fairness would require that the two shareholders receive the same fraction of the acquisition price.²⁷

Easterbrook and Jarrell comment generally on the fairness argument as follows:

[T]he equation of unfairness and abuse with unequal division assumes shareholders want equal divisions. There is no evidence that they do. It is more appropriate to assume that shareholders want to maximize the expected value of their shares, not to concentrate on how the gains are divided in a given case. Almost all shareholders are repeat players in the market. If they do not get cut in on the gains today, they will tomorrow.²⁸

We do not find it persuasive to argue that there is no evidence that shareholders want equal divisions. . Such a conclusion by Easterbrook and Jarrell begs the question; the starting point should be that shareholders should be treated equally unless there is a compelling reason for not doing so.

A fairness rule providing for an equal division of a control premium can be justified, not only on the inherent merits of justice, but also on the grounds of economic efficiency. Such a fairness rule is necessary to ensure the integrity of the markets so that investors will have the confidence to continue investing in the market. This argument appears to be particularly strong in Canada since Canadian investors, including portfolio managers, have historically regarded equal treatment as a very important component to investing in the public markets. Easterbrook and Jarrell have, however, acknowledged the importance of maintenance of investor confidence by advocating the position of the Department of Justice before the SEC Advisory Committee, “that tender offers be regulated only the absolute minimum necessary to ensure confidence in securities markets and equitable treatment of the smallest investors.”²⁹

²⁷ L.A. Bebchuk, Towards an Undistorted Choice and Equal Treatment in Corporate Takeovers: Discussion Paper No. 5 at the Programme in Law and Economics, Harvard Law School, 1 at 146-47 (Oct. 1984) [hereinafter “Bebchuk”]; see also L.A. Bebchuk, “Toward Undistorted Choice and Equal Treatment in Corporate Takeovers” (1985) 98 Harv. L. Rev. 1693.

²⁸ SEC Advisory Committee Report, *supra*, note 15 at 80-81. Ronen also dismissed the concept of fairness in a sharing of the control premium: “Existing legal doctrines offered in support of an obligation to provide an opportunity to noncontrolling shareholders to sell at the same terms as the dominant shareholder were reviewed and found lacking [from an economic efficiency point of view].” Ronen, *supra*, note 19 at 298.

²⁹ SEC Advisory Committee Report, *supra*, note 15 at 75.

Shareholders will not, however, be “repeat players in the market”³⁰ if they know they will not have any assurance of being treated fairly, that is, obtaining equal treatment with the controllers for their shares. Ronen concluded that an equal opportunity rule, such as provided by the Canadian legislation, was economically insufficient.³¹ Yet in his discussion of the concept of fairness he stated:

Can there be a socio-economic “rationale” for the Canadian rule which can make it economically efficient in a broader sense? Over the longer term? I doubt this is possible, but a speculation or two is too tempting to resist. . . .

. . . [I]n societies endowed with a common tradition, honorable conduct becomes legal tender; it facilitates transacting and preserves communal stability.³²

Put another way, Ronen seems to be suggesting that there is some credence in the view that paying a control premium can be beneficial by maintaining investor confidence in the capital markets, so that shareholders will continue to invest, thus assisting in the liquidity and economic efficiency of such markets. A fairness rule can be seen to contribute generally to the economic efficiency of the economy.

Bebchuk advances further economic efficiency arguments in favour of a fairness regime, in part on the basis of elimination of risk-bearing costs.

Let us assume that all of the given target shareholders have in case of a take-over an equal chance of being the beneficiary of the unexpected equal treatment. In this case all shareholders would consent *ex ante* to replace the unequal treatment regime by one of equal treatment so that each shareholder would receive with certainty his *pro rata* fraction of the acquisition price. . . .

. . . .

. . . By eliminating all risk-bearing costs the adoption of an equal treatment regime would make most shareholders better-off and no shareholders worse-off [This analysis] does suggest a clear efficiency consideration in favour of an equal treatment regime: as long as there is some element of randomness in determining shareholders’ fortunes under the current unequal treatment regime, ensuring equal treatment would produce efficiency gains by eliminating risk-bearing costs.³³

Bebchuk also argues that an acquisition should occur in accordance with what he terms the “undistorted choice objective.” That is, an acquisition should occur only if a majority of the target corporation’s shareholders view the offered acquisition price as higher than the value of the

³⁰ *Ibid.*

³¹ See Ronen, *supra*, note 19 at 295-96.

³² See *ibid.* at 296-97.

³³ Bebchuk, *supra*, note 27 at 143-44.

independent target and higher than other available offers.³⁴ The exercise of choice by all shareholders would, he argues, ensure that an acquisition would only succeed where a majority of the shareholders view the acquisition as value increasing, that is producing efficiency gains.³⁵

In Bebchuk's view, open market and privately negotiated acquisitions of control should, like general takeover bids, be regulated to ensure "undistorted choice" and equal treatment for all shareholders. Regulatory restraints to ensure undistorted choice and equal treatment for all shareholders would facilitate economic efficiency, as follows:

An equal treatment regime would substantially contribute to efficiency in two ways: by enabling target shareholders to exercise an undistorted choice, and by eliminating risk-bearing costs. . . . An equal treatment regime would be unlikely to involve any substantial efficiency costs. Thus an equal treatment regime would on the whole substantially contribute to efficiency. Hence, efficiency considerations do not provide a reason for deviating from equal treatment but rather strengthen the case for an equal treatment regime.³⁶

With respect to private acquisitions of control, Bebchuk proposes the following equal treatment regime to ensure that all shareholders will have an opportunity to exercise choice and participate in a sale of control: "A prospective buyer seeking to acquire a controlling interest should be limited to pursuing the avenue of a takeover . . . or of a merger. That is accumulation of shares through the open market or privately negotiated transactions should be prohibited from going beyond the specified threshold of a controlling interest."³⁷ The legislative resolution of the sale of control premium debate in Ontario was not necessarily predicated on the basis of either the corporate asset or the fiduciary duty theories, although both played a role in the discussion leading up to the enactment of the follow-up offer obligation. Legislators and regulators

³⁴ *Ibid.* at 9-10, 46-47, 126.

³⁵ *Ibid.* Thus, the exercise of such choice is desirable from the perspective of economic efficiency.

³⁶ *Ibid.* at 149.

³⁷ *Ibid.* at 157; see E.F. Green & J.J. Junewicz, "A Reappraisal of Current Regulation of Mergers and Acquisitions" (1984) 132 U. Pa. L. Rev. 647 at 673-76; compare U.K., Council for the Securities Industry, *The City Code on Take-Overs and Mergers* 11 (1976) (General Principle 34) with Recommendation 14 of the SEC Advisory Committee Report:

No person may acquire securities of an issuer, if, immediately following such acquisition, such person would own more than 20 percent of the voting power of the outstanding voting securities of that issuer unless such purchase were made (i) from the issuer, or (ii) pursuant to the tender offer. The Commission should retain broad exemptive power with respect to this provision.

SEC Advisory Committee Report, *supra*, note 15 at 23. The SEC Committee did not give guidelines for the suggested exercise of the exemptive power. The SEC, however, stated it had serious reservations about the recommendation and that the issue required further study; in this regard, see "Statement Concerning the Recommendations of the SEC Advisory Committee on Tender Offers: Hearings Before the House Subcomm. on Telecommunications, Consumer Protection, and Finance," 98th Cong., 2nd Sess. 13 at 26 (1984) (statement of John S.R. Shad, Chairman, SEC).

ultimately decided that fairness and maintenance of confidence in the capital markets demanded that there be some legal mechanism to assure that a control premium is shared with other shareholders by the seller of control. One might arguably be justified in departing from the concepts of fairness if it were necessary to assure that takeover bids were not unduly impeded, since takeover bids assist in achieving economic efficiency in the private sector. What evidence there has been to date does not, however, indicate that takeover bids in Ontario or Canada have been unduly impeded by the follow-up offer obligation. Legislators should implement an equal opportunity law, as has been the case in Ontario and Quebec, since one cannot, and perhaps should not, rely on the judicial system to develop either the corporate asset theory or the fiduciary duty theory to protect minority shareholders.

III. STATUTORY PROVISIONS

A. Ontario

The takeover bid regime of the *Act* provides for disclosure by offerors, time for dissemination of information, that the same offer must be made to all shareholders, pro rata take-up and pay requirements when the bid is not for all the voting shares, and several other rules designed to enable security holders to make informed decisions and to have an equal opportunity to dispose of their shares.³⁸ These provisions, which apply in general terms to all takeover bids, may be avoided where the offeror comes within one of the following exemptions in the *Act*:

- (1) Less than 5% of the voting securities of the target company are purchased within a twelve-month period.³⁹
- (2) The offer is for securities in a private company.⁴⁰
- (3) The bid is made utilizing the facilities of a stock exchange approved for the purposes of the exemption.⁴¹

³⁸ See *Act, supra*, note 5 at ss. 22-23; regulations, *supra*, note 5, at ss. 162-75 & Form 32 ("Take-Over Bid Circular").

³⁹ *Act, supra*, note 5 at s. 88(2)(d).

⁴⁰ *Ibid.* at s. 88(2)(b).

⁴¹ *Ibid.* at s. 88(2)(a). The O.S.C. has recognized the Toronto Stock Exchange [hereinafter "TSE"], the Alberta Stock Exchange and the Montreal Exchange for the purposes of the stock exchange bid exemption. See O.S.C. Policy 3.1E, 3 Can. Sec. L. Rep. (CCH), para 471-301 (1984). It should not seem surprising that a stock exchange bid is exempt from the follow-up offer requirement of section 91(1). Except with respect to "normal course purchases," where a premium over market cannot be involved, such a bid is made pursuant to the rules of the exchange, with advance notice to all shareholders who have the right to participate in the acceptances of the offer, so the mischief of the private agreement exemption is not present. The exemption for normal course purchases on a stock exchange at the rate of 5% of the outstanding shares every 30 days, was, however, too broad an exemption. See the TSE General By-Law Part XXIII, 4 Can. Sec. L. Rep. (CCH), para. 804-751, s. 23.01(6) (1984). Amendments passed by the TSE effective January 1, 1985 narrow the exemption to 5% in a twelve-month period and thus are consistent with the *Act*. See *Amendments to Part XXIII of the General By-Law and Policy Statement on Take-Over Bids Made Through the Facilities of The Toronto Stock Exchange* (1984) 7 O.S.C. Bull. 5235.

(4) The acquisition is made by and from a person or persons within a control group. (Control group is defined for this purpose as a combination of persons holding a sufficient number of securities to materially affect control with the proviso that a combined holding of more than 20% of the voting securities is deemed to materially affect control in the absence of evidence to the contrary.)⁴²

(5) The take-over is facilitated by a private agreement with a limited number of shareholders and not made generally to all shareholders.⁴³

Under the *Act*, a takeover bid need not necessarily be a bid for legal or even effective control to trigger the follow-up offer obligation. The threshold level for invoking the follow-up offer obligation is the acquisition of such number of the outstanding voting securities⁴⁴ of the target corporation which, when combined with voting securities then owned by the offeror and its associates and by persons acting in concert with the offeror,⁴⁵ will equal 20% or more of such outstanding voting securities.⁴⁶

Where an offeror relies upon the private agreement exemption, in order to avoid the general takeover provisions of the *Act*, the offeror triggers the follow-up offer obligation in the following circumstances:⁴⁷

⁴² *Act, supra*, note 5 at s. 88(2)(e). This provision assumes that no change in control has occurred notwithstanding that one corporate controller is disposing of its position and another controller is consolidating control. Such an acquisition can arguably be viewed as a change in control and this exception has been removed from the new takeover bid regime proposed by the O.S.C. See *infra*, Part V.

⁴³ *Act, supra*, note 5 at s. 88(2)(c).

⁴⁴ See *ibid.* at para. 1(1)(44) (“‘voting security’ means 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 option to purchase shares which upon its execution will materially affect control is not, at the time the option is granted, a takeover bid. *Re Trizec Equities Ltd. (No. 1)* (1984), 25 B.L.R. 290 (O.S.C.). Hence, an option to purchase voting securities is relevant to a takeover bid threshold only when it is exercised and, likewise, the market price of the securities for the purpose of determining whether or not a premium was paid is measured as of the date of the exercise of the option.

Non-voting shares are excluded from the takeover bid definition. The O.S.C. issued an interim policy providing that non-voting common shares should participate in any takeover bid made for the common shares of a corporation on the same terms and conditions. See *Draft and Interim Policy on Restricted Shares and Request for Comments* (Position Paper) (1984), 7 O.S.C. Bull. 988. If no bid were required to be made to the holders of non-voting common shares, controlling shareholders might have been able to retain a premium paid for sale of corporate control and avoid the operation of the principle of equal opportunity. The O.S.C., however, later rejected enforcement of this so-called “coat-tail” concept. See *infra*, note 96.

⁴⁵ See *Act, supra*, note 5 at s. 88(1)(h):

“[O]fferor” means a person or company other than an agent, who makes a take-over bid or an issuer bid and where two or more persons or companies make offers, (i) jointly or in concert, or (ii) intending to exercise jointly or in concert any voting rights attaching to the security acquired through the offers, then each of them shall be deemed to be an offeror if the offer made by any of them is a take-over bid.

⁴⁶ *Ibid.* at s. 88(1)(k). The issuance of treasury securities has been held to not constitute a “take-over bid.” See *Re Trizec Equities Ltd. (No. 1)* (1984), 25 B.L.R. 290 at 304 (O.S.C.) (shareholders held to have been treated equally in that a premium paid for treasury securities goes to the corporate treasury and benefits all shareholders).

⁴⁷ See *Act, supra*, note 5 at s. 88(2)(c), s. 91(1).

- (1) There must be a take-over bid as defined in the [Act]. The definition in the [Act] includes a requirement that a bid must be made to Ontario resident shareholders thus establishing a jurisdictional basis in Ontario for the application of the take-over bid rules.
- (2) The private agreement exemption must be relied upon by the offeror in order to avoid the general take-over bid provisions of the [Act].
- (3) There must be a published market in the class of securities acquired under the bid.⁴⁸
- (4) The offeror must have paid, under the private agreement, a consideration with a value in excess of the market price of the securities purchased. In general, the term "market price" is defined in the regulations enacted under the [Act] as 15% in excess of the simple average of the closing price, of the securities for each day on which there was a closing price and following not more than ten business days before the relevant date.⁴⁹ (The 15% so called "free trade zone" was intended to acknowledge the effect that general market volatility may have on parties attempting to structure complex business transactions.⁵⁰ The Commission is given the power to adjust the "market price" where it concludes that the price was affected by an anticipated take-over bid or by improper manipulation.)⁵¹

Under the *Act* the O.S.C. has discretion to grant exemptions from the follow-up offer obligation and other related relief.⁵² The O.S.C. may decide that an offeror did not acquire, through the offer, the power or authority to control the business of the target company and shall not be obligated to make a follow-up offer. As well, the O.S.C. may exempt any person from the follow-up offer obligation where, in its opinion, it would

⁴⁸ See *ibid.* at s. 88(1)(j):

"Published market," as to any class of securities, means a stock exchange recognized by the Commission for the purposes of this Part on which such securities are listed, or any other market on which such securities are traded if the prices at which they have been traded on that market are regularly published in a bona fide newspaper or business financial publication of general and regular paid circulation.

⁴⁹ See regulations, *supra*, note 5 at s. 163(3):

For the purposes of [section] 91(1) of the [Act], "market price" of a class of securities on a particular date is an amount 15[%] in excess of the simple average of the closing price of securities of that class for each day on which there was a closing price and falling not more than ten business days before the relevant date.

Section 163(1) of the regulations defines "closing price," and section 163(2) provides that where there are two published markets, the one with greatest volume should be used in the calculation. Section 163(4) provides that there has to be a closing price for the securities within ten days, or else it is deemed that there is no published market. See *ibid.* at s. 163(1)-(4):

⁵⁰ E. Pascutto, Legal Advisor, O.S.C., Address (International Association of Securities Administrators and Securities Organizations Annual Meeting, Summer, 1984) at 11 (E. Pascutto is now Director, O.S.C.).

⁵¹ *Act, supra*, note 5 at s. 99(b). See, e.g., *Re British Columbia Forest Products Ltd.* (1981), 1 O.S.C. Bull. 116 (O.S.C. found that the trading price of the offeree corporation's shares on the TSE was affected by an anticipated takeover bid and, therefore, set the market price at a figure which required a follow-up offer or a section 99 exemption order).

⁵² *Act, supra*, note 5 at s. 99.

not be prejudicial to the public interest to do so. Contemporaneously with the proclamation of the legislation, the O.S.C. issued a policy which indicated that exemptions from the follow-up obligation could be expected to be granted, except in certain specific circumstances, thus greatly narrowing the thrust of the *Act*.⁵³

Under the *Act*, civil liability is imposed upon an offeror who fails to make a required follow-up offer.⁵⁴ Other remedies available under the *Act* are:

- (1) A compliance order may be sought by the O.S.C. from the Onta-

⁵³ O.S.C. Policy 3-41, "Take-over Bids—Section 99 Applications For Exemptions From the Obligation to Make a Follow-up Offer After a Control Block Premium Transaction—*The Securities Act, 1978*" (1979), O.S.C. Bull. 232. In Policy 3-41, the O.S.C. formulated guidelines for the circumstances in which it would exercise its discretionary powers under section 99 of the *Act* to provide exemptions from the follow-up offer's obligation. The O.S.C. specified three categories which, it stated, had given rise to the policy concerns which resulted in the enactment of the follow-up offer obligation:

- (a) A sale of control where the result is clearly unfair or abusive to the remaining shareholders;
- (b) The sale of control follows a public distribution of equity securities of the same corporation (whether newly issued or derived from the control block) in which it may reasonably be assumed that investors relied on continued involvement of the controlling shareholder in the corporation's affairs, and the sale of control occurs within, say, ten years after the public distribution; or
- (c) The offeror proposes obtaining effective control at a premium through purchases from fewer than fifteen shareholders, none of whom individually has effective control, at a premium unavailable to the remaining shareholders.

Ibid. The O.S.C. stated that if the sale of control did not fall within any of the three categories, it would be favourably disposed to granting an exemption from the follow-up offer obligation, unless other circumstances indicated that the exemption would be contrary to the public interest. Even if the sale did fall within one of the listed categories, the commission indicated that it might, under the following six special circumstances, grant an exemption:

- (a) where national economic policy favours repatriation of control;
- (b) sale by an owner-manager to employees;
- (c) where the non-controlling shareholders waive the offer;
- (d) where a control block is transferred in a bona fide corporate reorganization where effective control of the block remains with the parent company but is held after the reorganization by an affiliate corporation;
- (e) the offeror makes available to the other security holders the consideration required by section 91(1) by means that do not technically qualify as an offer such as an amalgamation, a winding up with a distribution to the security holders of cash or assets or if the follow-up offer is made by some other person which might not be the offeree corporation; and
- (f) the offeror was required to purchase the control block without having made a voluntary decision to do so.

Ibid. O.S.C. Policy 3-41 was repealed in late 1982 and replaced only with a general statement in O.S.C. Policy 9.2 that exemptions from the follow-up offer would be granted in "appropriate circumstances." O.S.C. Policy 9.2, "Take-over Bids—Section 99 Application for Exemptions From the Obligations to Make a Follow-up Offer," 3 Can. Sec. L. Rep. (CCH), para. 471-902 (1984).

⁵⁴ *Act, supra*, note 5 at s. 129. The application limitation period, as set out in clause 135(b), provides that an action under section 129 must be commenced at the earlier of (i) 180 days after the plaintiff first had knowledge of the facts giving rise to the cause of action, or (ii) three years after the date of the transaction that gave rise to the cause of action.

rio Supreme Court;⁵⁵

(2) The O.S.C. may use its administrative power to order that trading be ceased in Ontario in respect of any securities;⁵⁶ and

(3) The O.S.C. may make a discretionary order removing any exemptions from the provisions of the [Act] enjoyed by a non-complying party.⁵⁷

B. *Quebec*

The *Quebec Act* contains general takeover bid provisions similar to those in the *Act*. In Quebec, the takeover bid provisions of the legislation are triggered when a person secures 20% or more of the voting securities of a corporation.⁵⁸ As in Ontario, a person who makes a takeover bid is forced to comply with the rules relating to disclosure, timing and other procedures for taking up tendered shares.⁵⁹ The *Quebec Act* provides exemptions from the takeover bid rules similar to the exemptions in the *Act*.⁶⁰ Unlike the *Act*, however, the private agreement exemption⁶¹ does not give rise to a follow-up offer obligation. If the consideration paid under a private agreement is 15% greater than the trading price,⁶² the exemption does not apply and the full panoply of the takeover bid provisions under the statute must be followed, including provisions requiring that the same offer be made to all shareholders and provisions mandating

⁵⁵ *Ibid.* at s. 122. In *Re McLaughlin and S.B. McLaughlin Associates Ltd.* (1981), 1 O.S.C. Bull. 98C, it was argued that the court should not make an order under section 122 requiring compliance, because liability for failure to meet the requirements of section 91(1) is specifically provided for in section 129 by way of a personal remedy to the security holder. It was contended that the *Act* should be interpreted as excluding the application of the general enforcement section, namely, section 122, in the absence of clear language in the *Act* that the general provision should apply in addition to the specific remedy under section 129. The Court of Appeal rejected this argument, stating that "[section] 129 is not intended to be an exclusive remedy. It is part of a scheme to ensure that there is a follow-up offer, and to secure the benefits which should be enjoyed by those entitled to receive it." *Re Ontario Securities Commission and McLaughlin* (1983), 141 D.L.R. (3d) 668 at 672, 40 O.R. (2d) 405 at 410. The general compliance remedy thus has been held to apply in addition to the specific remedy in the *Act*.

⁵⁶ *Act, supra*, note 5 at s. 123.

⁵⁷ *Ibid.* at s. 124.

⁵⁸ *Quebec Act, supra*, note 8 at s. 110. A security or interest enabling the holder to acquire a voting security at the relevant time by a single or several linked transactions is also considered to be a voting security. *Ibid.* at s. 111. The jurisdictional nexus of the *Quebec Act* for a takeover bid was similar to that of the *Act* since a takeover bid was subject to the *Quebec Act* where it is made to at least one security holder whose address on the books of the offeree issuer was in Quebec. *Ibid.* at s. 112. Recent amendments to the *Quebec Act* have, however, broadened the jurisdictional nexus. See *infra*, note 104 and accompanying text.

⁵⁹ *Ibid.* at ss. 121-42.

⁶⁰ For example, an exemption from the takeover bid rules is afforded to offerors who make their bid through the facilities of a stock exchange or through normal course purchases, that is, less than 5% in any twelve-month period. *Ibid.* at s. 116.

⁶¹ *Ibid.* at s. 116(2) (offeror is exempt where the bid is by way of private agreement with not more than fourteen shareholders and where the price paid for the shares under the private agreement does not exceed the 15% "margin of variation").

⁶² See *Regulations to the Quebec Act*, s. 187, 3 Can. Sec. L. Rep. (CCH) para. 553-462 (1983).

a pro rata take-up and pay requirement where the bid is for less than all of the outstanding shares. Whereas Ontario forces a follow-up offer, Quebec merely removes the exemption making the offeror effect a pro rata offer for all of the shares of the offeree corporation.

Like Ontario, the *Quebec Act* empowers the Quebec Securities Commission ("Q.S.C.") to exempt a person from the requirements of the *Act* where to do so would not be detrimental to the protection of investors.⁶³ The Q.S.C. has issued a policy statement⁶⁴ indicating that it would be amenable to allowing an offeror to exceed the 15% margin of variation permitted by section 187 of the regulations to the *Quebec Act* and still utilize the private agreement exemption in the following circumstances: (1) the offeror sought only the shares of the founders of the offeree corporation and the founders had made a major contribution to the offeree issuer and the offer is in the interests of all shareholders; (2) the offeror agrees to make an offer with the same conditions to all security holders of the same class; or (3) the offeror agrees to pay the other security holders of the same class a "topping-up" amount equal to the difference between the private agreement price and the trading price.⁶⁵

IV. PROBLEMS WITH THE FOLLOW-UP OFFER OBLIGATION

The legislative solution of the follow-up offer obligation gave rise to several serious problems which can generally be categorized as follows: (1) jurisdictional problems, since this solution was a provincial one and the capital markets are national in scope;⁶⁶ (2) uncertainty was created

⁶³ *Quebec Act*, *supra*, note 8 at s. 263.

⁶⁴ Policy Statement No. Q-2, "Take-over Bids," 3 Can. Sec. L. Rep. (CCH) para. 570-002 (1983).

⁶⁵ *Ibid.* at s. 1. The "topping-up" alternative under section 1(3) is analogous to the "topping-up" exemption discussed; see *supra*, note 53; in O.S.C. Policy 3-41; see also *infra*, note 82 with respect to the *Sklar* case.

⁶⁶ Statutes enacted by provincial legislatures are constitutionally restricted to regulating persons and property within the legislating province. That is, a provincial legislature cannot validly enact legislation that purports to create or alter legal rights in another province. To the extent that legislation attempts to regulate extraprovincial matters, it is invalid. See P. Hogg, *Constitutional Law of Canada* (Toronto: Carswell, 1985) at 265-82; see also A. Abel, *Laskin's Canadian Constitutional Law*, 4th ed. (Toronto: Carswell, 1973) at 408; P. Anisman & P. Hogg, "Constitutional Aspects of Federal Securities Legislation" in *Three Proposals for a Securities Market Law in Canada* (Ottawa: Minister of Supply and Services, 1979) 135 at 147. Notwithstanding the apparent simplicity of the rule, its application in the case law is fraught with confusion. This confusion is generated by the difficulty courts have had in determining when a statute overreaches its provincial boundaries and what criteria ought to be determinative of extraterritoriality.

The case law dealing with the extraterritorial application of provincial legislation is generally concerned with the question of whether a particular provincial statute, the validity of which has been challenged, in fact operates so as to have extraterritorial effect. An examination of these cases indicates the apparent existence of a presumption against the extraterritorial application of provincial legislation. The courts will endeavour to interpret provincial laws so that they will not have extraterritorial application and, thus, will be within the power of a province. A finding of statutory interference with extraprovincial rights generally results in courts declaring the legislation *ultra vires* as far as any extraterritorial application is concerned. See *Royal Bank of Canada v. R.* (1913),

about the circumstances in which the O.S.C. would grant exemptions from the follow-up offer obligation, particularly as it related to the issue of corporate control as the relevant consideration in making exemptions; and (3) valuation problems, particularly where the follow-up offer consideration consists of non-cash consideration.

A. Jurisdictional and Extraterritorial Application of the Act

Since the Canadian provinces other than Quebec, did not enact a follow-up offer obligation or other equal opportunity rule,⁶⁷ and because of the national character of many Canadian securities transactions, the O.S.C. developed, in general terms, three methods of enforcing the follow-up offer obligation with respect to transactions which could be regarded as having taken place outside of Ontario. The three methods, which are not mutually exclusive, can be categorized as: (1) a broad interpretation of the *Act* to find that a "take-over bid" has been made, thus giving rise to a follow-up offer obligation;⁶⁸ (2) in the absence of a

[1913] A.C. 283 (P.C.); *Credit Foncier Franco-Canadian v. Ross* (1937), [1937] 3 D.L.R. 365 (Alta. S.C.A.D.); *Beauharnois Light, Heat & Power Co. Ltd. v. The Hydro Electric Power Commission of Ontario* (1937), [1937] O.R. 818 (C.A.), aff'g (1937), [1937] O.R. 796 (H.C.).

With respect to the O.S.C.'s broad interpretation of its jurisdiction to mandate a follow-up offer obligation, the question is whether the O.S.C.'s action in so doing involves destruction or modification of a civil or contractual right existing outside of the province of Ontario. In seeking to impose a follow-up offer obligation on a party to a private agreement where rights have been created outside of the province, it may be that the O.S.C. is effectively modifying the rights of the affected party under the private agreement. In these circumstances, the courts could well find that the O.S.C., in broadly interpreting the *Act*, was giving it an extraterritorial application, and that the *Act* should not be so interpreted.

⁶⁷ See, e.g., *supra*, notes 8 & 10-11.

⁶⁸ See *Re Electra Investments (Canada) Limited* (1983), 6 O.S.C. Bull. 417; a copy of the Order, issued under sections 123 and 124, is published in (1983), 5 O.S.C. Bull. 9B. *E*, the offeror, acquired about 47% of the outstanding common shares of EPM, through the facilities of the Montreal Exchange ["ME"], which was not at the time recognized by the O.S.C. for the purpose of the stock exchange takeover bid exemption. *E* marginally exceeded the ME's normal course purchase exemption of 5% in any month by purchasing slightly more than 5% of the common shares of EPM in a 30-day period from residents of Ontario who sold through the ME. The O.S.C. held that there was a takeover bid made from Ontario by an Ontario resident to Ontario registered shareholders through the facilities of the ME and decided to make an application under section 122 of the *Act* for a compliance order that a follow-up offer should be made: "The legal question is an important one since it will determine whether the provisions for [sic] the [*Act*] could be circumvented . . . by listing the securities on an exchange outside of Ontario or arranging for the offer to be made and accepted outside of Ontario." 6 O.S.C. Bull. 417 at para. 420. The Court declined to adjudicate the matter of the constitutionality of the O.S.C.'s attempt to regulate a transaction which occurred in Quebec. In the Court's opinion, the O.S.C.'s application was premature because an appeal from the O.S.C.'s original decision was still pending. See *Re Ontario Securities Commission and Electra Investments (Canada) Ltd.* (1984), 45 O.R. (2d) 246 (H.C.).

With respect to other cases where the O.S.C. has given a broad interpretation of the *Act* to find a takeover bid for a transaction which could be considered to have taken place outside of Ontario, see *Re Caisse de Depot et Placement du Québec* (1982), 4 O.S.C. Bull. 498C (no follow-up offer was involved in this case); a copy of the Order, issued under section 124, is published in (1982), 4 O.S.C. Bull. 290B; *Re Atco Ltd.* (1980), [1980] O.S.C. Bull. 412.

But see *Re Humboldt Energy Corp.* (1983), 5 O.S.C. Bull. 8C, where the O.S.C. appeared to

“take-over bid” due to the lack of relevant connecting factors with Ontario, enforcement of the follow-up offer obligation as a policy matter through the O.S.C.’s “cease trade” and “denial of exemption” powers, under sections 123 and 124, respectively, of the *Act*;⁶⁹ and (3) a linked transaction policy whereby a private agreement purchase which does not constitute a takeover bid, usually because it constitutes a purchase of less than 20% of the voting shares, is linked to a subsequent or prior takeover bid, therefore requiring equivalency of consideration for the whole transaction.⁷⁰

reverse the broad jurisdictional base which it had claimed in cases such as *Electra, supra*, by requiring that there clearly be a “take-over bid” in order for there to be a follow-up offer requirement. *H*, a British Columbia corporation and a reporting issuer under the *Act*, entered into an agreement with a Swiss corporation, whose address was outside of Ontario, to purchase about 2.5% of the common shares of an Alberta corporation, also a reporting issuer under the *Act* and whose common shares were listed on the Vancouver and Alberta stock exchanges at a premium in excess of 15% of the market price. *H*’s acquisition, together with the holdings of its controlling shareholder, would have exceeded the takeover bid threshold of 20% under the *Act*. Thirty-three percent of the offeree corporation’s issued and outstanding capital was held by Ontario shareholders.

The O.S.C. held there was no “take-over bid” since the address of the Swiss corporation was outside of Ontario. The O.S.C. said it would not exercise any of its powers to compel a follow-up offer in the circumstances of the case. The O.S.C. did, however, somewhat confuse the matter by stating it was still of the view that it had a broad jurisdiction that might transcend provincial borders to force a follow-up offer: “The Commission noted that private agreements, the terms of which, or the circumstances of execution of which, might be regarded as abusive to minority shareholders or as having a negative impact on the capital markets could constitute the basis for Commission intervention.” *Ibid.* at 9C.

⁶⁹ The O.S.C. has tried to force follow-up offers in situations where issuers were not subject to the specific provisions of the *Act* on the ground that issuers that utilize Ontario capital markets by virtue of their listing on the TSE or otherwise should abide by the spirit of Ontario law. With respect to enforcement of the spirit of the *Act* beyond the borders of Ontario, see *Re CableCasting Ltd.* (1978) O.S.C. Bull. 37; *Re Kaiser Resources Ltd.* (1981), 1 O.S.C. Bull. 13C. See also *Re Turbo Resources Ltd.* (1982), 3 O.S.C. Bull. 14B (O.S.C. order extending time for Turbo to make its follow-up offer); 3 O.S.C. Bull. 67C (reasons for first Bankeno Mines Limited offer); 3 O.S.C. Bull. 57C (decision concerning second Bankeno offer); 3 O.S.C. Bull. 104C (reasons for decision for second Bankeno amended offer); 3 O.S.C. Bull. 65C (decision for July 9-10, 1981 hearing); 4 O.S.C. Bull. 403C (denial of exemptions pursuant to s.124); 3 O.S.C. Bull. 55C (Div. Ct) (dismissal of application for an order of prohibition), 3 O.S.C. Bull. 132C (C.A.) (dismissal of application to extend time period for appeal from Div. Ct order); *Re Turbo Resources Ltd. and Maison Placements Canada Inc.* (1982), 137 D.L.R. (3d) 264 (Ont. Div. Ct), 19 B.L.R. 309, aff’g *Ontario Securities Commission v. Turbo Resources Ltd.*, 3 O.S.C. Bull. 98C (H.C.) (granting of compliance order under section 122), and aff’g 3 O.S.C. Bull. 67C and 104C (decisions of O.S.C. on first and second Bankeno valuation hearings). In *Turbo* there clearly was no takeover bid in the private agreement transaction because the offeree shareholder’s address on the books of the offeree corporation was outside of Ontario. The O.S.C. assumed jurisdiction largely on the basis of an undertaking made following a stock exchange bid by Turbo to make a follow-up offer. See TSE Notices to Members, No. 3307, June 29, 1981 & No. 3318, July 9, 1981.

In another case, where an offeror stated in a press release it would make a follow-up offer to minority shareholders, the O.S.C. implicitly held that such a statement became a ground for the assumption of jurisdiction by the O.S.C. See *Re Universal Explorations Ltd.* (1981), 2 O.S.C. Bull. 52D (extension of temporary order denying exemption); 2 O.S.C. Bull. 55D (extension of temporary cease trading order); 2 O.S.C. Bull. 57D (temporary denial of exemptions); 2 O.S.C. Bull. 59D (Notice of Hearing).

⁷⁰ In February 1981, an O.S.C. Notice stated that it might be contrary to the public interest for

The O.S.C.'s broad interpretation of the *Act* to mandate a follow-up

an offeror to acquire all of the holdings of certain shareholders through private agreements, and thereafter, in a "linked transaction," to offer for only part of the publicly held shares. See Notice, "Take-over Bids—Private Contracts—Partial Bids" (1981), 1 O.S.C. Bull. 6A. In April 1981, the O.S.C. issued an addendum to Interim Policy 3-37, "Private Agreements Prior to or During a Take-over Bid or Issuer Bid," 1 O.S.C. Bull. 24E, which was later adopted by the O.S.C. as Policy 9.3B, "Private Agreement Prior to a Take-over Bid or Issuer Bid—Linked Transactions," 3 Can. Sec. L. Rep. (CCH) para. 471-903 (1983), and which specifically refers to linked or integrated transactions:

The Commission has been concerned that notwithstanding the intent of Part XIX of the [*Act*], in some situations, holders of large blocks of shares may be or perceived to be treated better than the holders of smaller numbers of shares by the offeror in the context of a take-over bid. . . . It is the policy of the [*Act*] [see section 91(3)] that all shareholders should be treated equally. Of concern particularly are partial take-over bids or issuer bids following or at the same time as private agreements for the purchase of all of the securities of the class sought from a particular holder.

For the purpose of section 91(3) of the *Act*, the O.S.C. has stated that "it is the view of the Commission that offering to purchase all the securities of a class of any holder pursuant to a private agreement will require that if the purchaser makes a linked or related take-over bid or issuer bid for the securities of that class, it must be made for all of the class of securities sought at a price at least as great as that paid in the private agreement." *Ibid.* With respect to private agreement purchases prior to making a takeover bid, the O.S.C. stated:

If such private agreements constitute a take-over bid exempted from the requirements of Part XIX by section 88(2)(c) and a follow-up offer is required pursuant to section 91(1), there appears to be no problem. But where the private agreements do not constitute a take-over bid or where it is exempted under section 88(2)(c) and no follow-up offer is required to be made, the Commission is concerned for the equal treatment of the remaining shareholders during the subsequent take-over bid. It is the view of the Commission that when such private agreements are entered into by a purchaser with the intention of making a take-over bid at a later date, they should be considered in determining whether the same consideration is being offered to all holders of the same class of securities for the purpose of section 91(3). For this purpose, the Commission will presume that this intention existed at the time of the private agreement where the announcement of the take-over bid is made within 180 days of the date of the private agreement. This presumption may be rebutted upon an application under section 99.

Ibid.

See *Re Trans Mountain Pipeline Co. Ltd.* (1982), 4 O.S.C. Bull. 552C; a copy of the Order, issued under sections 123 and 140, is published at 376B (cease trade order against a bid under Policy 9.3B). *X* purchased a block of Trans Mountain shares in a private transaction from *S*, whose address, on the books of Trans Mountain, was outside Ontario. The shares were purchased at a cash price of \$9.04 per share prior to making, but after announcing, a takeover bid for Trans Mountain offering *X* securities in exchange for Trans Mountain shares. At a hearing in December 1982, the O.S.C. decided that if *X* were to proceed with its offer, it would not be required to offer cash of \$9.04 per share. However, the O.S.C. held that the purchase from *S* was a "linked transaction" with the takeover bid, and decided to cease a trade of the *X* bid until *X* offered paper of a value at least equivalent to \$9.04 per share for each Trans Mountain share and sent two valuations of the consideration offered by the *X* takeover bid circular to Trans Mountain shareholders to substantiate the equivalency. Section 91(3) was held applicable, notwithstanding that the purchase from *S* was not a takeover bid. This interpretation of section 91(3) was, in effect, an assumption of jurisdiction by the O.S.C. for transactions not legally subject to the *Act* which took place outside Ontario. The result of the O.S.C. order in this case, from the point of view of the shareholders of Trans Mountain, was that the shareholders were to receive an offer of a value of at least \$9.04 per share or, if *X* elected not to continue with its offer, no offer whatsoever. Inland subsequently continued with its offer supported by valuations that its offer was worth at least \$9.04 per share. Trans Mountain challenged these valuations. After a hearing on the valuation question the O.S.C., now differently constituted since

offer obligation raises questions regarding the constitutional jurisdiction of the *Act* to modify civil rights existing outside of Ontario.⁷¹ In these circumstances, the courts might find that the O.S.C., in broadly interpreting the *Act*, was giving it an invalid extraterritorial application. It is difficult to argue that the obligation should be made applicable to a transaction outside of Ontario in a jurisdiction which does not have a similar equal opportunity law. Since the O.S.C. has a broad power to cease trade or remove exemptions under sections 123 and 124 of the *Act*, depending upon its view of the public interest, it can be argued that the O.S.C. can exercise its powers to indirectly force a follow-up offer, notwithstanding that there has been no takeover bid under the *Act*.⁷² However, the legislature has specifically provided that a follow-up offer is only to be required where there is a takeover bid as defined in the *Act*. The better view would appear to be that the O.S.C. should not exercise its enforcement powers where there is clearly no "take-over bid" in Ontario, since the legislature has expressed the circumstances in which the follow-up offer is to apply.⁷³ Moreover, the purported exercise of jurisdiction by the O.S.C. over transactions which take place outside Ontario is constitutionally unsound.

B. Discretionary Exemptions and the Control Issue

The *Act* sets 20% of the outstanding voting shares of the target corporation as the threshold that triggers the takeover provisions of the *Act*. However, the assumption that control is acquired when 20% of the outstanding voting securities is obtained may be rebutted, and an exemption from the takeover provisions of the *Act* may be granted in the discretion of the O.S.C. where it can be shown that control has not in fact been acquired.⁷⁴ The O.S.C. has considered a number of applications for ex-

the then Chairman and Vice-Chairman had ceased to hold office, decided to let Trans Mountain shareholders decide for themselves whether they wanted to accept the Inland offer. The O.S.C. thus did not address the valuation question but issued an exemption order under section 99(e) of the *Act* permitting the offer to proceed. See (1983), 5 O.S.C. Bull. 5C. See also *Re Genstar Corporation* (1982), 4 O.S.C. Bull. 326C, 20 B.L.R. 72 (post bid integration). In recent proposals for reform the O.S.C. has indicated that post-bid private purchasers would be prohibited for twenty days following a takeover bid. Pre-bid integration would continue to be regulated in accordance with O.S.C. Policy 9.3B. See *infra*, Part VI.

⁷¹ In seeking to impose a follow-up offer obligation on a party to a private agreement where rights have been created outside of the province, it may be that the O.S.C. is effectively modifying the rights of the affected party under the private agreement. See *supra*, note 66.

⁷² That is, due to the offeree corporation having Ontario or the offeree being a reporting issuer in Ontario or otherwise.

⁷³ Under this view, the language in sections 123 and 124 would have to be read in such a way as to make it consistent with the provisions of Part XIX of the *Act*, and perhaps more generally in order to take account of the constitutional limitations of the province, so as to ensure no unlawful extraterritorial application of the *Act*.

⁷⁴ In former Policy 3-41, the O.S.C. stated that substantial weight would be given to whether the offeror would, as a consequence of the private agreement transaction, acquire the practical authority to nominate (and presumably elect) a majority of the directors. See *supra*, note 53. This

emptions from the *Act* on the basis of a non-control acquisition. Where the offeror has been able to show that it has not acquired effective control of the target company and did not intend to seek control, the O.S.C. has generally granted the exemption.⁷⁵ In one case where an offeror increased its shareholdings in a corporation which was already effectively controlled by it, the O.S.C. rejected an application for an exemption and stated the takeover bid provisions of the *Act* were not restricted to control bids.⁷⁶

exemption is arguably a logical one within the context of the policy for the follow-up offer; where the offeror has not in fact paid a premium to acquire control, the offeror should not be obliged to make an offer to all shareholders.

⁷⁵ See *Re British Columbia Forest Products Ltd. (Part II)* (1981), 2 O.S.C. Bull. 6C; Order 1 O.S.C. Bull. 177B. AEC purchased by private agreement 28% of BCFP from *N*. It was submitted that effective control of BCFP would not rest with AEC but with a control group composed of AEC and two American corporations which together held a block of about 41% of BCFP. In addition, AEC and the American controllers had entered into a standstill agreement with BCFP under which they agreed not to change their pro rata interests for a period of ten years. The O.S.C. granted the requested exemption from the follow-up offer obligation on the condition that AEC consent to a section 124 order denying AEC the exemptions from the takeover bid requirements of the *Act* with respect to BCFP, so that if AEC were permitted to increase its holdings in BCFP, such an increase would be effected in Ontario in compliance with the takeover bid requirements of the *Act*, including the follow-up offer to BCFP's Ontario shareholders. See also *Re Dataline Inc.* (1982), 3 O.S.C. Bull. 48C. In this case, an employee fund and retirement plan acquired a 34% block of *D* in a single transaction, under circumstances that required a follow-up offer or an exemption order. A block of over 50% of *D* shares was held by a holding company which was owned by the president and chief executive officer of *D*; thus he had the power to control the affairs of *D* and to elect a majority of its directors. The purchasers acquiring the block submitted that they were passive investors with no interest in management or representation on the board and the O.S.C. granted an exemption from the follow-up offer obligation.

⁷⁶ *Re McLaughlin and S.B. McLaughlin Associates Ltd.* (1981), 1 O.S.C. Bull. 98C (3d), 14 B.L.R. 46, aff'd *Re McLaughlin and Ontario Securities Commission* (1981), 128 D.L.R. (3d) 256, 258 (Ont. Div. Ct) (leave to appeal to the Court of Appeal denied). The O.S.C. rejected McLaughlin's submissions regarding the policy of the legislation, stating that takeover bids were not restricted to control bids and pointing out that section 91(1) extended to all takeover bids regardless of the control nexus issue.

A committee [hereinafter "Practitioners Committee"] appointed by the O.S.C. to study the problems associated with the follow-up offer obligation recommended that control, rather than price, be the focus of a follow-up offer obligation. *Report of the Committee to Review the Provisions of the Securities Act (Ontario) Relating to Take-over Bids and Issuer Bids*, 1983, para. 5.09 at 17 [hereinafter "Review Committee Report"].

The central issue addressed by the Practitioners Committee was whether the purchase or sale of control should be a necessary prerequisite to the follow-up offer obligation. The implicit assumption of the takeover bid threshold is that the acquisition of a 20% holding involves the acquisition of effective control. (Under section 1(1)11(iii) of the *Act*, 20% is, in the absence of evidence to the contrary, deemed to affect materially the control of the issuer). Where an application for an exemption is made under section 99(a), arguably the *Act* should, as a legal matter, be interpreted as requiring a follow-up offer only where control, de facto or legal, is actually being acquired, unless the application for the exemption reveals special circumstances which lead the Commission to reach the conclusion that the result of granting the exemption would be oppressive to the minority shareholders.

C. Valuation Problems

1. The Private Agreement Consideration

The valuation questions involved with respect to the private agreement consideration has not generally given the O.S.C. many difficulties. The O.S.C. has strictly interpreted the legislation so that any premium above the 15% level, no matter how small, triggered the follow-up offer and held that the size of the premium over the 15% level should not be a governing factor in an exemption application.⁷⁷ Where securities form part of the consideration in a private agreement, the value of the securities has been generally held to be the market price on the date of the agreement.⁷⁸

2. The Follow-up Consideration

The follow-up offer obligation is satisfied by making an offer equivalent (as opposed to an identical offer) to the one made under the private agreement. A number of problems arose in assessing the value of the follow-up offer consideration which can generally be summarized as follows:

1. An offeror has 180 days from the date of the private agreement in order to make the follow-up offer.⁷⁹ This has led to the argument that in order to be equivalent the offer would have to contain a sum reflecting the time value of money.⁸⁰
2. Where securities alone are offered as consideration, the O.S.C. has determined that their value should be determined by reference to trading value or estimated trading value on a stock exchange and not intrinsic asset value.⁸¹

⁷⁷ *Re Ronalds Federated Ltd.* (1980), [1980] O.S.C. Bull. 304 at 311; *Re Atco Ltd.* (1980), [1980] O.S.C. Bull. 412 at 419. The 15% premium threshold is an arbitrary figure, but with fairness to the policy-makers, the line had to be drawn at some point and 15% appears to be a reasonable figure. In addition, the O.S.C. has held that "reasonable brokerage fees or other commissions" permitted by section 91(1) should be included only where such brokerage fees were actually paid. See, e.g., *Ronalds Federated, supra*, at 307-308.

⁷⁸ If the securities were acquired by the offeror at a cost in excess of the market value as of the date of the private agreement, the O.S.C. would accept the value as being the cost of such securities to the offeror. See *Re Atco Ltd.* (1980), [1980] O.S.C. Bull. 412. The O.S.C. also has the power to make determinations under section 99(b) to ensure that market price is not affected by an anticipated bid or market manipulation, and sections 91(3) and 99(d) ensure that collateral agreements do not result in one offeree receiving benefits not available to other shareholders. See, e.g., *Re John Labbatt Ltd. and Dominion Dairies Ltd.* (1981), 2 O.S.C. Bull. 1C; a copy of the Order is published in (1981), 1 O.S.C. Bull. 189B; *Re Royal Trustco Ltd.* (1980), [1980] O.S.C. Bull. 465.

⁷⁹ The length of time period exposed minority shareholders to the risk that as a result of business and economic changes the purchaser would not have the resources with which to make the follow-up offer. See, e.g., *Re Turbo Resources Ltd.* (1982), 3 O.S.C. Bull. 14B.

⁸⁰ See Notice, "Take-over Bids—Value of Consideration in Follow-up Offers" (1981), 2 O.S.C. Bull. 23A; *Re Ziebart Corp.* (1981), 1 O.S.C. Bull. 5B; *Ontario Securities Commission v. McLaughlin* (1982), 35 O.R. (2d) 11 at 14 (H.C.).

⁸¹ See *Re Turbo Resources Ltd.* (1982), 137 D.L.R. (3d) 265 at 273-74 (Ont. H.C.): "We are in complete agreement with this application and interpretation of [section] 91(1) of the Securities Act

3. A question arose whether the O.S.C. would accept some form of settlement in lieu of a follow-up offer. The O.S.C. has accepted premium payments made to shareholders to "top up" the market value of their securities in the target company as satisfactory compliance in lieu of the follow-up offer obligation.⁸² Under such a system, the market value of the shareholder's securities in the target company would be "topped up" with a cash payment by the offeror. The shareholder's shares in the target corporation would not be acquired, but the market value of each share held plus the premium payment would equal the consideration paid under the private agreement. Thus, the equal-treatment rule would be satisfied without the offeror having to acquire the shareholder's securities.

V. PROPOSED LEGISLATIVE REFORM

A. *The Reform*

Following the difficulties experienced with the follow-up offer obligation, the O.S.C. appointed the Practitioners Committee to make recommendations with respect to the equal opportunity rule and an alternative to the follow-up offer obligation.⁸³ Contemporaneously, representatives of the securities industry formed a committee to make recommendations with respect to the same issues.⁸⁴ Both the Practitioners Committee and Industry Reports recommended that the follow-up offer obligation be replaced with a model based on that of Quebec, that Ontario remove the follow-up offer obligation from the *Act* and amend the private agreement exemption so that it would only be available where no premium is paid above 15% over market price.⁸⁵ After studying both the Practitioners and the Industry Reports, the O.S.C. released a notice

. . . by the [C]ommission." The O.S.C. held that, where securities are offered, they are to be valued at their market price on the day that the follow-up offer is made. The O.S.C. explicitly rejected the submission that "value" should be regarded as "net asset value" rather than market price. See also *Re Sklar Manufacturing Ltd.* (1982), 3 O.S.C. Bull. 120C at 130C.

⁸² *Re PCL Ltd./Sklar Manufacturing Ltd.* (1982), 4 O.S.C. Bull. 27C. PCL proposed that it make a premium payment to "top up" the market value of the Sklar common shares in order to give a shareholder a package of securities which would have a value, taken together with the common share itself, that was equal to the consideration paid under the private agreement. The O.S.C. noted that the topping-up proposal had merit, since "one of the undesirable consequences of fulfilling the 'follow-up offer' obligation is the removal of the subject securities of the charter company from the range of securities available to the public." The O.S.C. stated that it would consider a topping-up proposal, "carried forward on a timely basis," i.e. within five to ten business days, as an adequate ground to grant an exemption from the follow-up offer obligation under section 99(e). Guideline (e) of former Policy 3-41 suggested that an exemption might be granted, under section 99(e) of the *Act*, from the follow-up offer obligation "[i]f the 'offeror' makes available to the other security holders the consideration required by section 91(1) by means that do not technically qualify as an offer . . ." See *supra*, note 53 at 239-40.

⁸³ See sources cited at *supra*, note 76.

⁸⁴ *The Regulation of Take-over Bids in Canada Premium Private Agreement Transactions Report of the Securities Industry on Take-over Bids*, 1983 [hereinafter "Industry Report"].

⁸⁵ See *Quebec Act*, *supra*, note 61.

together with proposed draft legislative amendments and a commentary thereon⁸⁶ reflecting a consensus with respect to some major policy issues regarding the revision of takeover bid legislation by the securities administrators of Alberta, British Columbia, Ontario, Quebec and the Director under the *CBCA*. Ontario,⁸⁷ Quebec⁸⁸ and British Columbia⁸⁹ have drafted legislative amendments to reflect the consensus, and the other provincial administrators will advocate the adoption of uniform or compatible rules in their provinces. The Director under the *CBCA* has indicated his agreement in principle with the consensus, subject to reservations regarding the takeover bid threshold of 20%, since the *CBCA* utilizes a 10% takeover bid threshold.⁹⁰ The major reforms which are advocated by the securities administrators are as follows:

1. The minimum threshold percentage to constitute a "take-over bid" would remain at 20% in provincial takeover bid legislation.⁹¹ However, the threshold level would no longer be 20% of outstanding voting securities but 20% of any outstanding class or other category of voting securities.⁹² Securities convertible into voting securities are taken into account in calculating the threshold in certain circumstances.⁹³

2. The *Quebec Act* will provide that where an offer is made to acquire more than 20% of a class of non-voting shares, it must do so in accordance with the takeover bid rules that apply to voting shares if the non-voting shares are traded on an organized market.⁹⁴ In Ontario the takeover bid rules would apply only with respect to a class of voting securities; the amendments are silent on the question of non-voting securities.⁹⁵ The O.S.C. intends, however, to regulate takeover bids for non-voting or restricted voting shares as a matter of policy, stating, "the substantive and procedural protections provided by the take-over bid rules should

⁸⁶ (1984), 7 O.S.C. Bull. 1-271 at 1-371 (draft legislation relating to takeover bids), 1-392 (commentary on the draft legislation) [hereinafter "Commentary"].

⁸⁷ Bill 159, An Act to Amend the Securities Act, 1st reading, December 13, 1984 [hereinafter "Bill 159"]. The bill died on the order paper. Ontario is currently revising its takeover bid amendments, and expects to bring forward new legislation in 1985.

⁸⁸ Bill 7, An Act to Amend the Securities Act, December 21, 1984 (Title IV; takeover provisions to be proclaimed in force in the future when Ontario legislation takes effect) [hereinafter "Bill 7"].

⁸⁹ Bill 37, 1985, repeals and replaces the *Securities Act* (British Columbia). Since Bill 37 is largely modelled on the Ontario legislation, the discussion in the paper refers to Ontario proposed amendments and compares them with the Quebec proposals.

⁹⁰ See the Commentary, *supra*, note 86 at 1-392; see also the *CBCA*, *supra*, note 2 at s. 187.

⁹¹ As recommended in the Industry Report, *supra*, note 84 at 46. See *Quebec Act*, *supra*, note 8 at s. 110; *Act*, *supra*, note 5 at s. 88(1)(j); Commentary, *supra*, note 86 at 1-396.

⁹² *Ibid.*

⁹³ Bill 7, *supra*, note 88 at s. 112 (limited to convertible securities within sixty days of a transaction or series of linked transactions); *Act*, *supra*, note 5 at s. 89(2); Commentary, *supra*, note 87 at 1-397. The definition "convertible security" in section 88(1)(d)(iii) includes an option to convert or exchange into a security that is exercisable prior to the expiration of the bid. This appears in accordance with O.S.C. reasoning in *Trizec* (1984), 25 B.L.R. 290.

⁹⁴ Bill 7, *supra*, note 88 at s. 115.

⁹⁵ Bill 159, *supra*, note 87 at s. 88(1)(j).

apply where an offeror makes an offer to acquire all or a certain percentage or number of Restricted Shares that are not voting securities," where greater than 20% of the outstanding shares of a particular class of non-voting or restricted voting shares are acquired.⁹⁶ The O.S.C. has stated that it intends to enforce this policy by the exercise of its "cease trade" powers or other sanctions under the *Act*.⁹⁷ In addition, the policy provides that in order to create non-voting or restricted voting equity, it will be necessary for non-controlling shareholders to vote in favour of their creation.⁹⁸

3. In order to deal with a concern that transactions between the 10% and 20% threshold level may also affect the control of an offeree corporation or be part of a series of related transactions that would affect control of an offeree corporation, an early warning notification system is proposed which would require a press release and the immediate filing of a report with the applicable securities regulators upon the acquisition of 10% or more of a class of voting securities,⁹⁹ and a new press release and filing where the previously reported interest is changed.¹⁰⁰

4. In Ontario, the definition of the term "take-over bid" will include offers made to a person or a company in Ontario. The purpose of this change is to correct a jurisdictional anomaly with respect to the current application of Part XIX of the *Act*. The *Act* now applies to an offer made to a holder of securities of an issuer whose address on the issuer's books is in Ontario. Thus, the *Act* currently appears to apply notwithstanding that the trade may be made outside Ontario between non-Ontario parties in securities of a non-Ontario issuer.¹⁰¹ On the other hand, the *Act* does not currently apply to offers made to a person or company in Ontario where the shares registered in the offeree's name are recorded with non-Ontario addresses. The change in the language in the proposed amendments is intended to include trades which will take place in Ontario even though the securities to be sold may not be registered in the name of an Ontario vendor, whether or not at an address in Ontario, and including situations where the securities are sold in street form with an address outside Ontario. As stated in the O.S.C. Commentary, "as a matter of public policy, where a take-over bid is made to a person or company in Ontario, irrespective of whether any security holders are registered with addresses in Ontario, the protections of the legislation should apply."¹⁰² A de minimus exemption from the *Act* is granted where the offer is made in accordance with the laws of another jurisdiction and there are few

⁹⁶ O.S.C. Policy 1.3 (1984), 7 O.S.C. Bull. 5358 at Part V, para. 1.

⁹⁷ *Ibid.*

⁹⁸ *Ibid.* at Part VI.

⁹⁹ *Quebec Act, supra*, note 8 at s. 147.11; Bill 7, *supra*, note 88 at s. 100a; Commentary, *supra*, note 87 at 1-396.

¹⁰⁰ *Quebec Act, supra*, note 8 at s. 147.16 (only a 2.5% increase); Bill 159, *supra*, note 87 at s. 100(a)(2) (any change).

¹⁰¹ See *supra*, note 47 and accompanying text.

¹⁰² Bill 159, *supra*, note 87 at 1-397.

Ontario shareholders.¹⁰³ Furthermore, the jurisdictional difficulties and extraterritorial applications of the *Act* encountered by the O.S.C. when dealing with a follow-up offer obligation should be solved largely by the adoption of uniform legislation in five of the Canadian provinces.

A bid will be deemed to be made in Quebec if the offeror acquires securities from at least one security holder having a connection with Quebec by his address on the books of the offeree company, his residence, or his presence in Quebec at any time during the bid.¹⁰⁴ However, a *de minimus* provision is included similar to that of the Ontario legislation. Where an offeror makes a takeover bid in accordance with legislative rules outside of Quebec, such a bid is exempt from Quebec's takeover bid rules if (1) there are fewer than fifty Quebec shareholders, or the Quebec shareholders own less than 2% of the securities of the class, (2) the takeover circular is sent to the Quebec holders, and (3) the offer to Quebec holders is the same as made to the other shareholders of the offeree company.¹⁰⁵

5. The private agreement exemption in the *Quebec Act* will remain substantially the same and reflects the model agreed to as a replacement to the follow-up offer obligation. The number of persons who can participate in private agreements is limited to five and the price may not exceed 15% over market price. Rather than require an equivalent follow-up offer if an offeror pays more than 15% over market price in private agreement acquisitions as the *Act* currently provides, the *Quebec Act* denies the private agreement exemption in those circumstances and requires that a takeover bid must be made *pro rata* to all shareholders.¹⁰⁶

In Ontario the legislation will remove the follow-up offer obligation and amend the private agreement exemption to that found in the *Quebec Act*.¹⁰⁷ The proposed technique can be referred to as the *pro rata* or restricted private agreement exemption. Under this scheme the maximum price (including commissions or fees) that may be paid on a private agreement purchase will be 15% over the trading price, calculated over twenty trading days using a simple average of closing prices. The securities regulators will have no discretion to determine a new trading or market price where the market is affected by manipulation or anticipation of a takeover bid. Rather, in such cases, the securities regulators could bring enforcement proceedings. In addition, the number of vendor shareholders in a private agreement exemption has been reduced from fewer than fifteen to five or less.¹⁰⁸ Accordingly, if a purchaser proposes to acquire control from more than five persons or companies or to pay a price in excess of 15% of the market price, it must make a formal take-

¹⁰³ *Ibid.* at s. 92(1)(e).

¹⁰⁴ Bill 7, *supra*, note 88 at s. 113.

¹⁰⁵ *Ibid.* at s. 121.

¹⁰⁶ *Ibid.* at s. 123.

¹⁰⁷ *Quebec Act*, *supra*, note 8 at s. 92(1)(c); Commentary, *supra*, note 86 at 1-401 to -402.

¹⁰⁸ *Ibid.*

over bid to all shareholders of the class of securities which have been purchased. If the bid is for less than all of the shares of the class, it must be made pro rata to all shareholders.

6. The prohibition of private agreement transactions at a premium will apply even where the offeror already has over 50% of the voting rights of the offeree corporation and is seeking to consolidate its control.¹⁰⁹ Price rather than legal control continues to be the nexus for the requirement for equal treatment of shareholders. In addition, there is no special exemption for control persons comparable to that now found in clause 88(2)(e) of the *Act*.¹¹⁰

7. A specific exemption for a "topping-up offer" has not been set out, since a topping-up was not considered to be equivalent to an offer for the minority shareholders' shares at the premium price. It is intended that a policy statement would be issued providing that an application for exemption would be entertained where the offeror proposes to make a topping-up offer with the approval of minority shareholders.¹¹¹

8. An anti-avoidance provision, similar to section 91(2) of the *Act* regulating true target corporations, has been included to deal with the possibility of avoidance of the rule through the use of a holding company.¹¹²

Where an offer is made to acquire voting securities of a corporation for which there is no published market, and thereby the offeror indirectly acquires beneficial ownership or control over securities of a corporation in which there is a published market, the offeror is deemed to have made an offer to acquire the securities of the issuer in which there is a published market. If an offeror acquired securities of a private corporation which owned securities of a public corporation, and thereby the offeror indirectly acquired more than 20% of the voting securities of the public corporation, the legislation provides that the offeror will be deemed to have made a takeover bid for the public corporation. If a premium of 15% over market was paid for the securities of the public corporation, the offeror would be subject to the takeover bid rules and would have to make an offer to all of the other shareholders of the public corporation.

9. The proposals contain a restriction on post-bid private purchases, whereby an offeror or any person associated or acting jointly with the offeror is prohibited from making private purchases in securities of the offeree issuer for twenty business days following the expiration of a takeover bid.¹¹³

With respect to pre-bid integration, O.S.C. Policy 9.3B currently provides that where a private agreement is entered into by the purchaser with the intention of making a takeover bid at a later date, the private agreement is considered in determining whether the same consideration

¹⁰⁹ Bill 159, *supra*, note 87; Commentary, *supra*, note 86 at 1-402.

¹¹⁰ Bill 159, *supra*, note 87 at s. 92(1).

¹¹¹ *Ibid.*; Commentary, *supra*, note 86 at 1-402.

¹¹² Bill 159, *supra*, note 87 at s. 91; *Quebec Act*, *supra*, note 8 at s. 114.

¹¹³ Bill 159, *supra*, note 87 at s. 93(4); *Quebec Act*, *supra*, note 8 at s. 144.

has been offered to all shareholders as required by section 91(3) of the *Act*. Policy 9.3B states that the O.S.C. will presume that the intention to make a takeover bid at a later date existed at the time of the private agreement if the takeover bid was announced within 180 days of the private agreement.¹¹⁴ The Practitioners Report recommended that the concept of pre-bid integration be incorporated into the legislation by a specific provision,¹¹⁵ but the securities administrators decided to continue to regulate the matter by Policy 9.3B.

10. In Ontario, Policy 9.2, which relates to applications for exemptions from the obligation to make a follow-up offer, will be revoked by the O.S.C. and replaced by a policy that will provide general guidance as to the limited circumstances in which the O.S.C. will consider exempting an offeror from the requirement to make a general takeover bid where an acquisition does not come within one of the exemptions set out in section 89(1) of the proposed legislation.¹¹⁶ It is apparent that the O.S.C. and Q.S.C. would only intend to exempt an offeror from the legislative requirements in unusual circumstances.

B. Commentary on the Proposed Reform

The pro rata model for dealing with private acquisitions contains advantages to the follow-up offer mechanism. Some of the advantages are as follows: First, the most important aspect of the proposals for reform is uniformity of approach, since Canadian securities markets are not confined within provincial boundaries. Since the securities administrators in at least four provinces will recommend the adoption of the proposal, uniform legislation will probably be implemented in the near future and will lead to greater certainty for Canadian investors and a resolution of some of the problems associated with the extraterritorial application of the *Act* by the O.S.C. It would be helpful if the federal government were to revise the takeover bid provisions contained in Part XIX of the *CBCA* to provide for an equal treatment rule for control premiums when the target corporation is subject to the *CBCA* on the same model as adopted by the provinces.

Second, the extent of administrative discretion has been substantially reduced. The O.S.C. will not be required to hold hearings to determine equivalency of value of a follow-up offer, since the offer must be made on identical terms to all shareholders if it does not conform with the limitations provided for in the restricted private agreement exemption. Moreover, the O.S.C. will not have the power to determine a revised "market price" as currently exists, where the market for the shares of the public company has been affected by an anticipated takeover bid or by improper manipulation. Where there is a concern that the market

¹¹⁴ See sources cited at *supra*, note 70.

¹¹⁵ Review Committee Report, *supra*, note 76 at 18.

¹¹⁶ Bill 159, *supra*, note 87; Commentary, *supra*, note 86 at 1-414.

had been manipulated, enforcement proceedings could be taken by the O.S.C.

Third, there is greater certainty of what offer will be made to the minority and when it will be made. All shareholders will be made an offer on the same terms and at the same time as the controlling shareholder.

Fourth, one technique which is of considerable interest from a social engineering point of view is the power given to the O.S.C., in section 99 of the *Act* (section 103 of the proposed Ontario amendments), and to the Q.S.C., in section 263 of the *Quebec Act*, to exempt proposed transactions from the otherwise applicable requirements of the legislation. This rather unique power is perhaps the main reason why the O.S.C., based at the center of Canadian capital markets, has come to play such an important and sometimes controversial role as a quasi-judicial administrative body. The power to grant exemptions will permit certain flexibility while greater certainty for all market participants will be provided as it is not intended that there will be many circumstances in which exemptions from the legislation will be granted. It is submitted that the unconditional exemption power should be continued, but should be granted only in extraordinary cases. At the present time, the only significant exemption apparently being considered by the securities administrators is the ability of a purchaser of control to be granted an exemption in circumstances analogous to the "topping-up" proposal.¹¹⁷ The purchase would have to be approved by minority shareholders, and the purchaser must agree to pay the minority shareholders the difference between the price paid to the controlling shareholders and the market price at the time of the purchase without having to purchase the minority shares.

Fifth, part of the ongoing debate as to the scope of an equal treatment rule has focused upon the widespread use in Canada of non-voting, restricted voting, or multiple voting shares as a technique to enable a corporation to raise public funds through the issuance of equity without the controller of the corporation losing, or risking the loss of, control. As a result of this technique,¹¹⁸ while the equity of a corporation, in terms of sharing in dividends or in participating in residual values on a winding up of a corporation, may be widely held, the percentage of such equity which carries full voting rights can be held, or held to the extent of effective or legal control thereof, by a controller or a controlling group. This is limited the potential of a general offer made for voting securities of a corporation.

Peter Dey, then the Chairman of the O.S.C., discussed the question in the following terms:

Securities regulators might exercise their powers to ensure that all new issues of non-voting common shares contain the so-called "coat-

¹¹⁷ Bill 159, *supra*, note 87; Commentary, *supra*, note 86 at 1-402.

¹¹⁸ O.S.C. Policy 1.3, *supra*, note 96.

tail" provisions which ensure that if a take-over bid is made for the voting shares, which is accepted by a specified percentage of the voting shares, the bid must be made to the non-voting shareholders on comparable terms.

....

A requirement that such a provision be included in the terms of all non-voting shares would not meet with much resistance, because the business and investment communities are already including these provisions in the terms of many of the new issues.

....

Even accepting that non-voting equity shares are part of the Canadian finance scene, are there situations where the relationship between the control exercised by the controlling shareholders and the equity held by them is so out of balance that the situation is intolerable? Does some line have to be drawn, beyond which the integrity of the markets is compromised?¹¹⁹

A draft policy and discussion document circulated by the O.S.C., provided that the terms attached to non-voting or restricted voting equity shares must provide that if a takeover bid is made for voting securities without a corresponding offer to purchase the non-voting or restricted voting shares at equivalent consideration to the voting shares, then the holders of the non-voting or restricted voting shares would participate in the takeover bid through the right to convert to fully voting shares in order to accept the takeover bid.¹²⁰

The O.S.C. believes that it is inequitable and contrary to the public interest to allow corporations to raise equity capital through restricted share issues without imposing a requirement of equal treatment in a takeover bid or other sale of control situation for the reasons stated in the following excerpt from the Industry Take-Over Bid Report:¹²¹

[I]f equal treatment within a class is to be the rule, the rule should logically extend to all classes of residual equity shares. This position would be advanced on the theory that *if fairness and investor confidence are primary concerns*, then consistency and the goal of real equality of treatment require that restricted or special common shares, which represent equity ownership in an enterprise, should be included in any premium control transactions. As a consequence, provisions ensuring that the owners of such shares would have an opportunity to participate in a take-over bid for the common shares ("coat-tail provisions") should be included in the shares' attributes.¹²²

Ultimately, the O.S.C. decided in the final version of Policy 1.3 to not enforce, as a legislative matter, a coat-tail provision in the context of a takeover bid, or to require corporations to include such coat-tail provi-

¹¹⁹ Remarks of Peter Dey to the Conference Board of Canada (1983), 6 O.S.C. Bull. 4283 at 4287-88.

¹²⁰ *Re Trizec Equities Ltd.* (1984), 25 B.L.R. 290 (O.S.C.).

¹²¹ Industry Report, *supra*, note 84.

¹²² (1984), 7 O.S.C. Bull. 988 at Part IV A; see *supra*, note 44.

sions in the terms of all non-voting shares. Instead, Policy 1.3 provides, among other things, that in order to create non-voting or restricted voting equity in the future, it would be necessary for the non-controlling group of shareholders to vote in favour of such action, and that where an offer is made for non-voting shares, such an offer must comply with the takeover bid rules in circumstances where they would apply for voting shares.¹²³ The Q.S.C. made a similar decision with respect to restricted shares. It does not require that coat-tail provisions be provided in the attributes of restricted shares or be provided as a legislative provision.¹²⁴ The Quebec legislation provides, however, that an offer for non-voting shares must be made in accordance with takeover bid rules.

Some economists might argue that enforcing a coat-tail provision for non-voting securities in the context of a takeover bid could impede takeover bids by making them more costly. On the other hand, it could be argued that takeover bids may be impeded to the extent that non-voting securities enable majority interests to consolidate control.¹²⁵ In any event, we think that overriding considerations of fair treatment and concomitant maintenance of investor confidence in the capital markets would suggest that all holders of equity should participate in a change of control. We concur with the views of the Toronto Stock Exchange, which has stated:

It would be harmful to the credibility of the trading markets for control to change hands at a premium under a sale of one class of residual equity shares, probably held by a restricted group of holders, when no bid is made for publicly distributed residual equity shares with lesser, or no voting rights. The real questions lie in what should be done to meet the situation.¹²⁶

The premium relates to control, and therefore should perhaps logically apply only to voting shares. Perhaps, as a matter of corporate law, there should be limits on the creation of non-voting participating shares. Alternatively, provisions should perhaps be made to ensure the inclusion of non-voting residual equity shares when a takeover bid is made for the full voting shares.

VI. CONCLUSION

At the time the follow-up offer obligation was introduced in Ontario in 1978, the debate centered around the benefits of an equal treatment

¹²³ O.S.C. Policy 1.3, *supra*, note 96 at Part V.

¹²⁴ For the Q.S.C. decision on restricted shares, see Vol. XV, No. 42, Q.S.C. Bull.

¹²⁵ For an interesting discussion of economic arguments relating to the issuance of non-voting shares, see Pesando, *Restricted Shares and the Efficiency of the Capital Market* (July 9, 1984) (background paper prepared for Consumer and Corporate Affairs, Canada).

¹²⁶ *The Toronto Stock Exchange Submission to the Ontario Securities Commission Concerning the Regulation of Non-Voting, Multiple Voting and Restricted Voting Common Shares*, 1981, at 16; TSE Notice to Members, No. 3560, April 14, 1982 ("Re: The Toronto Stock Exchange's Policy Statement on Restricted Shares") & Appendix A at 1.

rule. Those opposing an equal treatment rule at that time had enough strength to extract from the Minister responsible for the *Act* a commitment that, simultaneously with the proclamation of the *Act*, he would arrange for the O.S.C. to introduce a policy statement indicating a broad use by the O.S.C. of the power to exempt transactions from the follow-up offer obligation.¹²⁷ The policy statement was introduced but was largely ignored by successive members of the O.S.C. who apparently did not have much sympathy with the concept of widespread exemption orders from the follow-up offer obligation. Gradually, the debate has shifted away from the pros and cons of an equal treatment rule to the scope of any such rule and the legal techniques for making such a rule workable.

Fairness and justice require that the control premium be shared and we do not believe that there is any justification for departing from the inherent rules of fairness. We remain unpersuaded by economic arguments that a control premium should not be shared with minority shareholders in order to facilitate economic efficiency. Indeed, in Canada an equal treatment rule appears to be necessary to maintain investor confidence in the public markets. While we do believe that the sale of control transactions and takeover bids generally can be beneficial to the economy, we do not believe that a sale of control premium would unduly impede either sales of control or the takeover bid technique in general. Certainly we are unaware of any empirical study which would justify such a conclusion and Ontario's legislative solution, the follow-up offer obligation, does not appear to have unduly impeded takeover bid techniques in Ontario or Quebec.

We believe that the new legislative solution which has been agreed to by the securities administrators from the five largest provinces will simplify the application of the implementation of the legislative solution in Canada. The solution requiring that offers above a certain threshold premium 15% greater than market is a good one which should result in fewer problems than experienced with the follow-up offer obligation. The question of equal treatment to non-voting shareholders in the context of a takeover bid made for the voting securities is, however, an outstanding issue. It remains to be seen whether the discipline of the market place will ensure that there will be voluntary provisions when such non-voting shares are created by a corporation allowing them to be converted to voting shares in the event of a takeover bid or whether legislative action is necessary.

¹²⁷ Statement by The Hon. L. Grossman, Minister of Consumer & Commercial Relations (June 15, 1978), reprinted in O.S.C.'s *Weekly Summary*, Supplement "X" at 4 (11 August 1978).