CANADA BUSINESS CORPORATIONS ACT

DISCUSSION PAPER

TAKE-OVER BIDS

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EXECUTIVE SUMMARY

TAKE-OVER BIDS

Generally, a take-over bid is an offer to all or most shareholders to purchase shares of a target (offeree) corporation, where the offeror, if successful, will obtain enough shares to control the target corporation. Take-overs are an important market mechanism by which a person can seek to replace inefficient management with more competent management. Hence, take-overs can help allocate resources to more productive uses. The primary objective of the CBCA's take-over bid provisions is to ensure that the rights and interests of the various parties involved in a take-over bid -- shareholders, the offeror and the target corporation -- are adequately protected.

The objective of this paper is to generate discussion regarding proposals to amend the take-over bid provisions of the Canada Business Corporations Act (CBCA), including the option to repeal these provisions. The paper examines ways to improve the regulation of take-over bids in Canada and considers the appropriate contribution that the CBCA can make to that regulation.

However, the recommendations and options contained in this paper are not in any sense the final word on changes to the CBCA's take-over bid provisions. They represent current thinking but are not government or even departmental policy. This paper, and the consultations that will follow, are intended to solicit from the public their views on take-over bid regulation under the CBCA.

Potential Repeal of CBCA Take-over Bid Provisions

During the preliminary consultations undertaken by Industry Canada in 1994, CBCA stakeholders suggested two major directions which the amendments could take:

1. Eliminate the take-over bid part of the CBCA and leave the regulation of take-over bids to provincial securities laws;

2. Amend the CBCA to harmonize it with provincial laws and improve it relative to that legislation where possible.

The principal argument for repealing the CBCA's take-over bid provisions is that this would reduce duplicative regulation of the same subject matter. The provincial securities laws provide detailed, carefully crafted, comprehensive codes for the regulation of take-over bids of publicly-traded companies. The combined reach of the various provincial securities laws operate collectively to catch substantially all, if not all, bids for publicly-traded CBCA corporations.

On the other hand, those involved in a take-over bid would likely still have to comply with the provisions of the various provincial and international jurisdictions in which there are sufficient shareholders affected by the bid. The resulting savings from eliminating the CBCA's provisions may not be very large.

Moreover, the issue of duplicative filings could be dealt with through blanket exemption orders issued, where appropriate, by the CBCA Director. This would eliminate, to a significant degree, duplicative filing and still provide for take-over bid regulation of CBCA corporations which would not be subject to the take-over bid provisions in provincial securities statutes. However, questions may be raised as to whether it is worthwhile maintaining the CBCA's take-over bid requirements if the CBCA Director would exempt the vast majority of take-over bids from the CBCA's requirements.

The paper recommends that the take-over bid provisions of the CBCA be retained and up-dated based on the proposals made in the rest of this document.

Proposals for Amending CBCA's Take-over Bid Provisions

If the CBCA's take-over bid provisions are retained, modernization of these provisions needs to be considered. The paper discusses 23 proposals to amend the CBCA's take-over bid provisions, largely harmonizing them with provincial securities laws. Some of the more important issues include the take-over bid threshold, early-warning disclosure, expanding the minimum bid period from 21 to 45 days and compelled acquisitions.

With respect to the **take-over bid threshold**, the CBCA and the provincial securities laws use a numerical threshold to define when effective control of a corporation has been achieved. Currently, the take-over bid provisions of the CBCA apply if an offeror, after making a bid for shares of a target corporation, would control or own 10 percent or more of any class of shares of an offeree corporation. The main arguments for moving the CBCA to the 20 percent threshold level are that the move would promote greater harmonization with provincial securities laws, and that the 20 percent threshold level is more appropriate for Canada. All the provincial securities statutes with take-over bid provisions currently set the threshold at 20 percent. The paper recommends raising the threshold to 20 percent.

The recommended change in threshold to 20 percent could in some cases delay the availability of key ownership information to shareholders and potentially injure their position by allowing others to gain significant share acquisitions without their knowledge. In order to deal with this problem, the provincial securities statutes have adopted **early warning disclosure provisions**. The paper examines the appropriateness of adding early warning disclosure requirements to the CBCA and recommends against it because they would largely be duplicative of provincial securities laws. The paper also considers recent arguments that the early warning disclosure threshold be reduced from 10 percent to 5 percent to increase the level of disclosure available to regulators and the public.

On the issue of whether to expand the **minimum bid period**, the paper notes that some difficulties are created for CBCA corporations because provincial securities laws and the CBCA do not specify the same time limits and because shareholders and directors may not have enough time to adequately analyze a bid. The paper proposes expanding the minimum bid period to 45 days, in addition to a number of other changes in the periods specified in the take-over bid rules.

The paper also considers whether to amend the CBCA to give minority shareholders the right in certain circumstances to compel the corporation to purchase their shares. The offeror who acquires 90 percent of the outstanding shares of a class is granted under CBCA subs. 206(2) a right to acquire the remaining shares. This acquisition right obliges non-tendering shareholders to sell their shares and permits the majority shareholder to "take the corporation private." However, the CBCA does not address the concern that, if the offeror decides not to take up their shares, some shareholders may be left in an extreme minority position with shares that are no longer listed or are thinly traded. That minority group of shareholders is also unlikely to have any significant influence in the running of the corporation. The paper proposes adopting a **compelled acquisition** right.

Defensive Measures

Lastly, the paper considers one of the most controversial issues arising in connection with hostile take-over bids: the proper role of the target corporation's managers and the tactics they may employ in responding to a hostile take-over bid. Numerous defensive measures, with exotic names like poison pills, golden parachutes and white knights, have been developed. The common feature among all defensive measures is that the corporate management, using the broad powers and often huge resources at its disposal, acts to prevent the success of an actual or potential bid. For example, the most common defensive measure, the poison pill, would make it extremely difficult/expensive for a hostile bidder to gain control of the target corporation without the cooperation of its management.

Several theories have been put forward regarding the use and effect of defensive measures. One theory is that defensive measures are beneficial because they allow managers to focus on the operation of the corporation and manage it with an eye towards the long term. A second theory argues that defensive measures are used by managers to entrench themselves. A third theory is that defensive measures are used primarily to increase management's bargaining power in potential take-over negotiations.

The paper examines whether the directors' fiduciary duties should be redefined and/or whether a code of conduct should be adopted. With respect to fiduciary duties, the paper recommends that no legislative change be made in the definition of the fiduciary duties. The courts should be left to develop the concepts of what is in the best interests of the corporation in hostile take-over bid situations. However, the paper does recommend that a code of conduct be adopted in the CBCA to regulate the conduct of management in a hostile take-over bid situation, so that:

(A) anticipatory defensive measures would be invalid unless approved by a majority of shareholders;

(B) anticipatory defensive measures would be invalid unless reaffirmed by shareholders annually;

(C) defensive measures taken in respect to a particular take-over bid or bids be approved by a committee of independent directors and be approved by shareholders as soon as it is reasonably possible and, in any event, not later than the next special or annual shareholders meeting; and

(D) a shareholders' resolution approving any defensive measures must not be linked with another measure (for example a special dividend).

CANADA BUSINESS CORPORATIONS ACT

TAKE-OVER BIDS

1. INTRODUCTION

[1] The objective of this paper is to generate discussion regarding proposals to amend the take-over bid provisions of the Canada Business Corporations Act[1] (CBCA), including the option to repeal these provisions.[2]

[2] The paper reviews:

- the rationale for government regulation of take-over bids;
- the suggestions for amendments presented by participants in the initial round of the consultations process;
- the arguments for and against repeal of the take-over bid provisions of the CBCA;
- the proposals for updating the take-over bid provisions of the CBCA if they are maintained; and
- the issue of take-over bid defensive measures.

[3] The ultimate goal of the paper is to examine ways to improve the regulation of take-over bids in Canada and consider the appropriate contribution that the CBCA can make to that

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1 R.S.C., 1985, c. C-44, as amended.

2 This discussion paper relies on work contained in a number of background papers which were commissioned.

The firm of Stikeman, Elliott, Barristers and Solicitors was retained to examine the CBCA's take-over bid provisions. The paper, prepared by William J. Braithwaite, is entitled "Evaluation Report on the Take-over Bid Provisions of the Canada Business Corporations Act", and was completed in March, 1995.

Professor Raymonde Crête of the University of Laval, Faculty of Law, was retained to compare the CBCA with provincial securities legislation. Her report, entitled "Comparison of the Canada Business Corporations Act with Provincial Securities Legislation," was completed in August of 1994.

Warren Grover of the firm of Blake, Cassels and Graydon was retained to examine take-over bid issues. Some of the reports produced were: "Proposed Amendments to Part XVII of the CBCA - Take-over Bids" (March, 1990); "The Take-over Bid Threshold" (November, 1990); and "Defensive Tactics: Management's Role in the Face of a Take-over Bid" (November, 1990).

regulation. One consideration is the benefit of CBCA take-over bid regulation in relation to the regulatory burden it places on those subject to its provisions. Another consideration, also with a view to reducing unnecessary regulation, is further harmonization of CBCA rules with those arising under provincial securities laws. However, some recommendations in the paper do deviate from the existing provisions found in provincial securities and corporate statutes. This has been done where it is believed that the CBCA take-over bid provisions could, if maintained, improve upon existing provincial laws.

[4] The recommendations and options contained in this paper are not in any sense the final word on changes to the CBCA's take-over bid provisions. They represent current thinking but are not government or even departmental policy. This paper, and the consultations that will follow, are intended to solicit from the public their views on take-over bid regulation under the CBCA.

2. BACKGROUND

A. WHAT ARE TAKE-OVER BIDS AND WHY ARE THEY REGULATED?

[5] Generally, a take-over bid is an offer to all or most shareholders to purchase shares of a corporation, where the offeror, if successful, will obtain enough shares to control the target corporation. The full definition in the CBCA is somewhat more complicated, and defines a "take-over bid" as,

> an offer, other than an exempt offer, made by an offeror to shareholders at approximately the same time to acquire shares that, if combined with shares already beneficially owned or controlled, directly or indirectly, by the offeror or an affiliate or associate of the offeror on the date of the take-over bid, would exceed ten percent of any class of issued shares of an offeree corporation and includes every offer, other than an exempt offer, by an issuer to repurchase its own shares.[3]

[6] Take-over bids constitute one mechanism through which a transfer or change of corporate control can be achieved. In this manner, take-overs are an important mechanism in the market by which a person, who perceives that a corporation's performance is below potential, can seek to

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[3] CBCA, s. 194.

replace inefficient management with more competent managers.[4] Hence, take-overs can help allocate resources to more productive uses.

[7] The primary objective of the CBCA's take-over bid provisions is to ensure that the rights and interests of the various parties involved in a take-over bid -- shareholders, the offeror and the target corporation -- are adequately protected. For instance, one purpose of the CBCA's take-over bid provisions is to protect the bona fide interests of shareholders of the offeree corporation subject to the take-over bid (the "target" corporation). However, the effort to protect shareholders must be balanced with the desire not to unduly impede potential bidders. Government regulation endeavours to help ensure the fair and orderly conduct of take-over bids through a framework setting out the rights and obligations of the parties involved. Some of the ways it does this is by:

- requiring information relevant to the decision whether to accept or reject the offer to be given to those shareholders to whom a take-over bid is made (offerees);
- ensuring that the offerees have enough time to assess the information and make a reasoned decision;
- requiring that the target corporation's board of directors be given information relevant to their decision whether to recommend acceptance or rejection of the bid;

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[4] This is not the only reason why an offeror would endeavour to take-over a target corporation. Other reasons include:

· SYNERGY: The offeror believes that if his/her firm were combined with the target corporation, the assets and personnel of the two firms would gel in such a way that the combined worth of the two corporations would be more than if they remained separate (synergistic gain).

· MARKET POWER: The offeror believes that if the target corporation and his/her corporation were combined, it would reduce market competition and thus increase market power.

· TAX CONSIDERATIONS: There may be tax gains from combining the two companies where, for example, the target corporation has losses that it will not be able to use in the foreseeable future and the offeror corporation has a profit.

· UNDERVALUATION: The offeror believes that the target corporation's shares are undervalued by the market and that they will rise in the future.

· LOOTING: The offeror believes that by selling off the assets of the target corporation, he or she will receive more money than the price paid for the entire corporation. In essence, this is a specialized case of the undervaluation reason.

· EMPIRE BUILDING: The offeror, or the offeror's management, wants to acquire the target corporation in order to increase the size of the offeror firm and receive greater prestige/compensation that may accompany the acquisition.

- ensuring that the target corporation's board of directors is given enough time to assess the take-over bid;

- ensuring that the offer is made to all shareholders of the shares sought; and

- requiring all shareholders to be treated equally with respect to both the price offered and the portion of their shares which will be taken up in an oversubscribed partial bid.

[8] The CBCA's take-over bid provisions apply to all corporations whose shares are publicly-traded or who have more than 15 shareholders. In this regard, offerors wishing to make a take-over bid for a CBCA corporation may be subject not only to the CBCA's take-over bid provisions but also to the provincial securities laws[5] in jurisdictions where the securities of the CBCA target corporation are traded.[6]

[9] Related to take-over bids are measures (for example, poison pills) designed to thwart unwanted take-over bids or to provide the corporation's management with more time to analyze the bid and, where appropriate, seek other bidders.[7] These are referred to as "defensive measures." Part XVII of the CBCA (take-over bids) does not currently regulate defensive measures, however, the directors' fiduciary duties apply to actions taken in response to take-over bids[8] and the Canadian Securities Administrators have issued National Policy 38. To protect the interests of shareholders, National Policy 38 sets forth general principles to guide regulators as they assess the appropriateness of any defensive measure.

B. DEVELOPMENT OF TAKE-OVER BID REGULATION

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[5] Provincial securities laws regulate take-overs for publicly-traded companies. However, the CBCA also captures take-over bids for certain privately-traded corporations with more than 15 shareholders, which the provincial securities laws do not.

[6] The provincial securities laws are broader than the CBCA in their application with respect to take-over bids because they govern trades in securities and not just shares. The definition of "securities" is much broader than "shares." The term "securities" includes debt obligations as well as shares, and under some securities laws it also includes profit sharing agreements.

[7] Poison Pills: Typically a poison pill is a scheme that allows a target company to issue new stock at a steep price discount to existing shareholders - except the bidder - in order to make the take-over prohibitively expensive. Poison pills are also referred to as shareholder rights plans.

[8] CBCA, s. 122.

[10] The take-over bid provisions in the CBCA were first enacted in 1970 as amendments to the Canada Corporations Act[9] (CCA). In 1975, the CCA's take-over bid provisions were largely carried over to the CBCA. These provisions were originally designed to be in harmony with those in the Ontario Securities Act[10] (OSA) and the various other provincial securities statutes.[11] However, since enactment, the OSA has been amended numerous times to respond to new developments in the area of take-overs, securities markets, and the foreign and domestic business environment. In contrast, it has been 25 years since the CBCA's take-over bid provisions were updated. As a result, the take-over bid provisions in the CBCA have become outdated and inconsistent with provincial legislation.

[11] For some years now, the provinces -- in particular, Quebec, Ontario, British Columbia and Alberta -- have endeavoured to harmonize their securities laws. The adoption of National Policy statements by the Canadian Securities Administrators (CSA) is evidence of these efforts to increase harmonization.[12] Further pressure is being placed on corporate and securities law administrators to harmonize their laws because they are now operating in an environment where globalization of capital markets is occurring and greater emphasis must be placed on harmonizing Canadian laws with those of Canada's major trading partners.

3. CONSULTATION RESULTS

[12] During the preliminary consultations undertaken by Industry Canada in 1994, CBCA stakeholders suggested two major directions which the amendments could take:

1. Eliminate the take-over bid part of the CBCA and leave the regulation of take-over bids to provincial securities laws;

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[9] R.S.C., 1970, c. C-32.

[10] R.S.O., 1990, C. S.5.

[11] The following securities acts also regulate take-over bids:

British Columbia (BCSA), S.B.C., 1985, c. 83;
Alberta (ASA), R.S.A., 1981, c. S-6.1;
Manitoba (MSA), R.S.M., 1988, c. S50;
Nova Scotia (NSSA), R.S.N.S., 1989, c. 418;
Newfoundland (NSA), R.S.N., 1990, c. S-13;
Quebec (QSA), R.S.Q., c. V-1.1; and,
Saskatchewan (SSA), S.S., 1988, c. S-42.2.

[12] See the following for an example of this cooperative effort to standardize take-over bid regulation: Canadian Securities Administrators (CSA) National Policy no. 38, Take-over bids - Defensive Tactics.

2. Amend the CBCA to harmonize it with the various provincial legislation and improve it relative to that legislation where possible. More specifically:

- Provide a clearer definition of "take-over bid";
- Raise the take-over bid threshold to 20 percent from 10 percent;
- Add a "declaration of intent" for institutional investors who cross the take-over bid threshold;
- Provide the CBCA Director with the ability to grant exemptions from the take-over bid provisions along the lines of the Ontario Securities Commission exemption power;
- Add an early warning system, if the threshold is raised to 20 percent, so that the CBCA is consistent with other jurisdictions such as Ontario;
- Provide take-over bid information to non-residents;
- Make identical the time periods for total and partial bids in take-overs;
- Increase the minimum time period during which offerees may deposit their shares so as to give them more time to consider the take-over bid; and
- Eliminate private agreement exemptions when the corporation has a class share structure.[13]

4. REPEAL OF CBCA TAKE-OVER BID PROVISIONS

[13] As mentioned previously, the 1994 consultation results indicated that many individuals felt the CBCA's take-over bid provisions should be repealed. This section examines the arguments for and against repealing the CBCA's take-over bid provisions and provides a preliminary recommendation.

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[13] A corporation has a dual class share structure when voting rights, the right to receive dividends and the right to receive property after dissolution, vary by class of share (CBCA subs. 24(4)). However, stakeholders in the above case seem to be referring to the situation where voting structures vary between classes so that one class of shares held by the controlling shareholders has superior power (e.g. one class given 1 vote per share, another class 500 votes per share).

A. ARGUMENTS FOR REPEALING THE CBCA'S TAKE-OVER BID PROVISIONS

[14] The principal argument for repealing the CBCA's take-over bid provisions is that this would reduce duplicative regulation of the same subject matter. The provincial securities laws provide detailed, carefully crafted, comprehensive codes for the regulation of take-over bids of publicly-traded companies. To a large extent, the combined reach of the various provincial securities laws operate collectively to catch substantially all, if not all, bids for publicly traded CBCA corporations. Only when all the offeree shareholders of a CBCA corporation are located in Prince Edward Island (P.E.I.), New Brunswick (N.B.), the Yukon, the Northwest Territories (N.W.T.)[14] or outside Canada could a take-over bid for that corporation escape provincial regulation. Given the structure of the Canadian capital markets, it is very unlikely that a take-over bid of a publicly-traded company would escape provincial regulation. Normally, there is at least a minimum number of shareholders resident in one of the provincial jurisdictions that regulates take-over bids. As a result, offerors almost always have to comply with the take-over bid provisions of one of the provinces.

[15] However, compliance with the take-over provisions of one province does not necessarily mean that the bid will be made to shareholders in those provinces without take-over bid rules in their securities laws (P.E.I., N.B., the Yukon and the N.W.T.). This concern is alleviated to a large extent by the practical reality that because no take-over bid legislation exists in these jurisdictions, the offeror bears no additional regulatory costs or burdens in making the bid available to shareholders in these jurisdictions. In practice, offerors are not inclined to deliberately exclude shareholders from an offer. In addition, National Policy 37 of the Canadian Securities Administrators could be used to ensure that all security holders of a target corporation are treated equally, regardless of the province in which they reside.[15]

[16] Given that most take-over bids are captured by provincial legislation, the benefits of maintaining the CBCA take-over bid regime may be minimal. Unless significant value is added by the CBCA take-over bid requirements (in terms of a difference in the legislation, application of the law, and/or enforcement efforts), then avoiding duplication is a factor in favour of repealing the CBCA take-over bid requirements.

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[14] The securities laws of these provinces do impose a regulatory scheme for take-over bids.

[15] CSA National Policy 37: "Take-over Bids - Reciprocal Cease Trading Orders." This policy provides that, in the appropriate circumstances, where a take-over bid is made to shareholders in some provinces, but is not also made to shareholders in one or more of the other provinces, the securities regulators may issue cease trading orders in respect of the bid.

[17] Moreover, additional compliance costs are imposed on CBCA corporations, offerors and others through having to analyze the CBCA take-over bid rules in addition to rules under applicable provincial securities laws. Differences in approach, or even minor wording discrepancies, may increase the compliance costs.

[18] A more basic argument for repealing the CBCA take-over bid provisions is that the benefit of take-over bid regulation to shareholders or any other corporate stakeholder, other than management, has been questioned. Studies in the United States[16] raise some doubt as to whether take-over bid regulation benefits any non-management constituency of the corporation and argue that shareholders may suffer direct wealth losses as a result of take-over bid regulation.

[19] It can also be argued that corporations, their management and shareholders may be able to effectively negotiate their own take-over bid rules. Poison pills are, in essence, take-over bid regulation. There may be concerns that such plans favour one corporate constituent (for example, management over shareholders, or institutional investors over retail investors) and therefore mandatory rules need to be legislated. Through market pressures, however, poison pills have recently been largely redesigned to be more acceptable to shareholders.[17] As an alternative, the legislation could adopt a take-over bid scheme that corporations, with shareholder approval, could opt out of. Transaction costs could be reduced for many corporations and shareholders, while the market could regulate arrangements by corporations and shareholders who decide to opt out of the statutory scheme.

B. ARGUMENTS FOR MAINTAINING THE CBCA TAKE-OVER BID PROVISIONS

[20] In order to alleviate the high degree of duplication mentioned earlier, the CBCA allows the Director appointed under the CBCA to exempt persons from some of the take-over bid requirements. New section 258.2, when it is proclaimed in force, will permit the Director to issue blanket exemption orders in cases where similar notices or documents are required to be filed under other federal or provincial legislation. Such orders, if made with respect to take-over bids, could significantly reduce the number of notices or documents required to be filed with the Director as a result of the CBCA's take-over bid provisions.

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[16] See, for example, Romano, "A Guide to Takeovers: Theory, Evidence and Regulation" (1992) 9 Yale J. on Reg. 119; Jarrell, Brickley & Netter, "The Market for Corporate Control: The Empirical Evidence Since 1980" (1988) 2 J. of Economic Perspectives 49.

[17] See discussion in Issue 6 "Defensive Measures" below.

[21] However, s. 258.2 does not deal with duplication in respect of documents that must be provided to shareholders. Because of this limitation, consideration could be given to whether the Director's exemptive relief capacity should be expanded (see Issue 5(R)). The ability to issue blanket orders exempting, for example, offerors who comply with another approved regime, could permit the CBCA Director to deal with most, if not all, cases of regulatory overlap. Reliance on this new exemption power in these circumstances could avoid duplication by requiring only those not subject to provincial take-over bid provisions to comply with the CBCA's take-over bid requirements. In addition, reliance on the exemption power would maintain a federal presence in the enforcement of take-over bids, and may be an alternative to repealing the take-over bid provisions of the CBCA. However, questions may be raised as to whether it is worthwhile maintaining the CBCA's take-over bid requirements if the CBCA Director would exempt the vast majority of take-over bids from the CBCA's requirements.

[22] The elimination of the CBCA's take-over bid provisions would have very little effect on the duplicative regulation of take-over bids. Those involved in a take-over bid would likely still have to comply with the provisions of the various provincial and international jurisdictions in which there are sufficient shareholders[18] affected by the bid. The resulting savings from eliminating the CBCA's provisions may not be very large.

[23] While one of the main reasons for take-over bid regulation is to protect the integrity of capital markets,[19] there are also important corporate law reasons for regulating take-over bids. For instance, take-over bids have a very significant effect on corporate governance. Certain of the duties imposed upon directors of a target corporation when responding to a take-over bid are fiduciary in nature and thus appropriate matter for corporate law.

[24] As mentioned earlier, given the structure of the Canadian capital markets, it is very unlikely that a take-over bid of a public company would escape provincial regulation. However, some CBCA corporations only issue securities in the United States.[20] If the CBCA's take-over bid provisions were eliminated, such corporations would only be subject to the take-over bid provisions administered by the United States Securities and Exchange Commission (SEC) and not those of a Canadian regulator. Provincial securities laws, currently do not apply to take-over bids involving CBCA corporations that issue securities only in the United States. While the practice of only issuing securities in the United States is somewhat rare at the moment, it may become more common in the future.

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[18] Most provincial securities statutes require at least 50 shareholders whose last address is in the province. See for example: OSA, par. 93(e).

[19] Protecting the integrity of capital markets has traditionally been the principal concern of securities laws.

[20] Preliminary research found that there are at least seven such public corporations.

[25] Some have argued that increased trading across provincial and national boundaries supports the need for a comprehensive regulatory framework to address take-over bids that cross provincial or national borders. Because the CBCA provisions cover all CBCA corporations, regardless of the jurisdiction in which they conduct business or issue securities, the provisions provide uniform legislation and protection for investors. While the provinces have worked at harmonizing their securities statutes, there are still some significant differences.[21] However, the take-over bid provisions of these provincial securities laws are not significantly different. This means that there already exists a large degree of national uniformity with respect to take-over bids. In fact, the current CBCA take-over provisions detract from this uniformity by having some different requirements than those in the provincial securities statutes, although the implementation of changes reviewed in Part 5 of this paper would further harmonization.

[26] A further argument for maintaining the CBCA's take-over bid provisions is that although the CBCA is different, which adds to the regulatory burden placed on those involved in a take-over bid, these differences can be justified if they improve upon provincial securities statutes. At what point the added regulatory burden of the CBCA's take-over bid provisions outweigh the value derived from the differences is difficult to assess.

[27] Some have argued that by maintaining CBCA regulation of take-over bids, the federal government can have a positive impact on the development and advancement of take-over bid provisions in other jurisdictions. For example, the CBCA could specify longer deposit and withdrawal periods during a take-over bid.[22]

[28] Finally, by maintaining jurisdiction over take-over bids with respect to CBCA corporations, the federal government can ensure that present and future policy objectives, which may not be identical to those of the provincial governments, can be achieved.

C. RECOMMENDATION

[29] That the take-over bid provisions of the CBCA be retained and up-dated based on the proposals made in the rest of this document. The issue of duplicative filings could be dealt with

[21] For instance, there remains inconsistency between the provincial statutes in terms of the penalty for a breach of the insider trading provisions. In Ontario a person who contravenes any part of the OSA is guilty of an offence and is liable to a fine of up to $1 million and/or imprisonment of up to two years. On the other hand, in Manitoba a person who contravenes the insider trading reporting requirements is liable to a maximum fine of only $1,000. This means that penalties could vary for insider contraventions depending on the provincial statute under which a prosecution is pursued.

[22] See Issue 5(J), "Expanding Minimum Bid Period and Other Time Period Related Issues."

through blanket exemption orders issued, where appropriate, by the CBCA Director. This would eliminate, to a significant degree, duplicative filing and still provide for take-over bid regulation of CBCA corporations which would not be subject to the take-over bid provisions in provincial securities statutes.

[30] This recommendation is predicated on the premise that the take-over bid provisions in the CBCA can add sufficient value over and above the provincial securities law requirements, either through a difference in their application or through a difference in policy choices, to warrant their retention. One of this paper's main recommended departures from current provincial securities legislation's take-over bid requirements, is that the CBCA provide for longer time periods with respect to take-over bids.[23] This recommendation is based on the belief that the current minimum time periods for take-over bids are too short.

5. PROPOSALS FOR AMENDING CBCA'S TAKE-OVER BID PROVISIONS

[31] If, as recommended, the CBCA's take-over bid provisions are retained, modernization of these provisions needs to be considered. Some changes proposed to the CBCA's take-over bid provisions are discussed below.

A. TAKE-OVER BID THRESHOLD[24]

Issue:

[32] Whether to re-define "take-over bid" as an offer to acquire 20 percent or more of any class of shares.

Background:

[33] One of the goals of the CBCA's take-over bid provisions is to regulate attempts to acquire legal or effective control of corporations. The CBCA and the provincial securities laws use a

[23] See Issue 5(J).

[24] Source: OSA, subs. 89(1); QSA, s. 110; BCSA, subs. 74(1).

numerical threshold to define when effective control of a corporation has been achieved.[25] Currently, the take-over bid provisions of the CBCA apply if an offeror, after making a bid for shares of an offeree corporation, would control or own 10 percent or more of any class of shares of an offeree corporation. In the interest of harmonization, it may be desirable to increase the CBCA threshold to the 20 percent level found in provincial securities laws.

[34] Many reports which have examined what percentage of ownership should trigger take-over bid regulation in Canada. The Kimber Report[26] proposed a threshold of 20 percent of voting shares of a class and this is what was adopted by the provinces in their securities laws. Nevertheless, in 1970, when the take-over bid provisions were first enacted in federal corporate law, a threshold of 10 percent was adopted. The materials prepared for Parliament explaining the policy rationale for the provisions (the 1970 briefing book) explained that the 10 percent figure "has been selected, instead of 20 percent, to take account of the fact that 10 percent ownership of the voting shares of a company is often sufficient to ensure effective control of the affairs of the company." The Dickerson report,[27] which formed the basis of the CBCA, argued that the 10 percent threshold was a reasonable compromise between the 20 percent found in provincial securities laws and the 5 percent threshold used in the United States.

> The U.S. Securities and Exchange Act is somewhat broader in its application. In effect, it goes back one step further to require disclosure whenever any person acquires 5 percent of the voting shares of a corporation. . . In 1970 the U.S. Congress passed an act reducing the bloc of shares requiring such special disclosure from 10 percent to 5 percent, indicating that Congress thought that more disclosure was required in respect of creeping acquisitions. Although the 10 percent base adopted in the present Act was adopted before the U.S. law was amended, it appears to be a reasonable compromise between the Ontario law and the U.S. law. . .[28]

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[25] The CBCA could apply a functional definition as opposed to a threshold (for example, the take-over bid provisions apply when a shareholder acquires "effective" control). This system would avoid the main disadvantage of the bright-lines method which is that it is somewhat arbitrary and, for some corporations, real control may be obtained at a percentage below the threshold (or for others above the threshold). However, the bright lines approach clearly specifies to all marketplace participants the point when the rules apply and, as a result, it promotes compliance and permits easier enforcement.

[26] J.R. Kimber, Chairman, The Report of the Attorney General's Committee on Securities Legislation in Ontario, Ontario Queen's Printer, Toronto, 1965 (the Kimber Report).

[27] Dickerson, Robert W.V., Howard, J. L., Getz, L., Proposals for a New Business Corporations Law for Canada, vol.I, Information Canada, Ottawa, 1971 (the Dickerson Report).

[28] Ibid. pages 144-145.

[35] Since the Dickerson Report, studies have recommended both the 20 percent and the 10 percent level.[29]

[36] In the United Kingdom, a numerical take-over bid threshold is set out in The City Code on Take-overs and Mergers[30] (the "City Code"). It states that once a party obtains 30 percent or more of the **voting rights** of a company, it must make a "mandatory" offer to all remaining shareholders (of any class of shares) of the company.[31] This 30 percent figure is the point at which "control" is defined for the purposes of the City Code.

[37] The main arguments for moving the CBCA to the 20 percent threshold level are that the move would promote greater harmonization with provincial securities laws, and that the 20 percent threshold level is more appropriate for Canada. As mentioned earlier, all the provincial securities statutes with take-over bid provisions currently set the threshold at 20 percent and presently there is no indication that any of these laws will be changed to adopt the 10 percent threshold. The opinion has been expressed that, in light of the limited number of widely held corporations in Canada, bidders almost invariably have to acquire at least 20 percent of the issuer's shares in order to exercise control. In support of this, a recent study found that only 23.1 percent of Canadian public corporations are widely held[32] while in the United States 40.2 percent of public corporations are widely held.[33] This indicates that, in a large majority of Canadian situations, bidders must acquire at least 20 percent of a publicly-traded corporation's shares in order to exercise control.

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[29] See for example:

- Report of the Securities Industry Committee on Take-over Bids, The Regulations of Takeover Bids in Canada: Premium Private Agreement Transactions, November, 1983 (Recommending a 20 percent level); and
- Request for Comments: Proposed Changes to Provincial Securities Legislation - Take-over Bids, (1990) Vol. 13 OSCB 2295 (recommending a 10 percent level).

[30] The City Code does not have the force of law.

[31] It should be noted that the 30 percent level in the City Code applies to voting rights and not to a class of issued shares as in the provincial securities statutes and the CBCA.

[32] The corporation is said to be "widely held" if no shareholder or group of related shareholders own, directly or indirectly, more than 20 percent of the voting shares.

[33] Someshwar Rao and Clifton Lee-Sing, "Governance Structure, Corporate Decision Making and Firm Performance in North America" in Ronald Daniels and Randall Morck, eds., Corporate Decision-Making in Canada, University of Calgary Press, Calgary, 1995, pp. 47-48.

Recommendation:

[38] It is proposed that the current CBCA take-over bid threshold of 10 percent be increased to 20 percent.

[39] There are some CBCA corporations with no shareholders holding more than 20 percent of the corporation's shares, but with one or more shareholders possessing 10 to 20 percent of the shares. In such cases, the recommended change would delay the availability of key ownership information to shareholders and potentially injure their position by allowing others to gain significant share acquisitions without their knowledge. In order to deal with this problem, the provincial securities statutes have adopted early warning provisions. The next issue in this paper examines the appropriateness of adding early warning disclosure requirements to the CBCA.

B. EARLY WARNING DISCLOSURE[34]

Issue:

[40] Whether to amend the CBCA to require "early warning" disclosure of significant share acquisitions.

Background:

[41] The main purpose of an early warning regime is to ensure that the marketplace is promptly informed of accumulations of significant blocks of securities that may influence control of a distributing corporation. The provincial securities statutes, which impose a take-over bid threshold of 20 percent, provide for early warning disclosure. For instance, s. 101 of the OSA states that

> Every offeror that acquires beneficial ownership of, or the power to exercise control over, or securities convertible into, voting or equity securities of any class of a reporting issuer that, together with such offeror's securities of that class, would constitute 10 percent or more of the outstanding securities of that class,
>
> a) shall issue and file forthwith a press release containing the information prescribed by the regulations; and

[34] New Provision. Sources: ASA, subs. 141(1); BCSA, subs. 93(1); MSA, subs. 92(1); NSA, subs. 102(1); NSSA, subs. 107(1); OSA, s. 101; QSA, s. 147.11.; SSA, subs. 110(1).

b) within two business days, shall file a report containing the information as is contained in the press release issued under clause (a).

Disclosure is also required for any additional 2 percent or greater acquisition of securities.

[42] Over the past forty years, there has been a dramatic change in the way Canadians invest their savings. Canadians have reduced their emphasis on self-directed investment in securities markets and instead have entrusted their dollars to institutional investors who manage their investments for them. As a result, the size of equity holdings and aggregate market power of institutional investors has increased dramatically.

[43] During the preliminary consultations on the CBCA held in 1994, some suggested that managers for institutional investors whose aggregate holdings exceed the 10 percent threshold, be exempted from the CBCA's take-over bid requirements. Those making this argument stated that institutional investors who surpass the 10 percent threshold are not "active" in the affairs of the corporation and should not be treated the same as other shareholders. The managers of these funds, in essence, are not interested in making a take-over bid for the corporation. In addition, it was argued that these managers trade in securities as part of their job and that the take-over bid requirements just add unnecessary paper burden.

[44] None of the provincial jurisdictions requiring early-warning disclosure currently provide for an institutional investor exemption. However, the Ontario Securities Commission (OSC) recently released a draft rule on "The Early Warning System and Related Take-over Bid, Insider Trading and Control Block Distribution Issues."[35] The proposal seeks "to recognize the increasing diversity and integration of the Canadian financial services industry."[36] The two most important changes suggested by the OSC proposal are (1) alternative monthly reporting; and (2) aggregation relief.

[45] Alternative monthly reporting would allow a "passive investor" to file an early warning report within 10 days after the end of the month if the voting or equity securities owned or

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[35] The OSC's proposals were publicly released on October 20, 1995 in (1995) Vol. 18 OSCB 4887. The proposals are outlined in two documents which are entitled:

> "Notice of a proposed rule under the Securities Act (Ontario): The Early Warning System and Related Take-over bid, Insider Trading and Control Block Distribution issues"; and

> "Rule #! Under the Securities Act (Ontario): The Early Warning System and Related Take-over bid, Insider Trading and Control Block Distribution issues."

[36] Page 1 of the notice on the proposed rule.

controlled by that person exceed 10 percent or more of the securities of a class.[37] As mentioned earlier, s. 101 of the OSA currently requires that a press release be issued immediately after, and that an early-warning report be filed within 2 days of the person owning or controlling 10 percent or more of a class of shares. The "aggregation relief" proposal is designed to provide for exemptions from early warning reporting, insider reporting, take-over bid and control block distribution prospectus requirements to permit dis-aggregation of independently managed holdings of securities, including independently managed mutual funds.[38]

[46] The CBCA does not currently have an "early warning" disclosure system. However, with the recommendation in this paper to move to a 20 percent threshold, it may be appropriate to introduce early warning provisions, similar to those in provincial securities laws, into the CBCA. If the CBCA were to introduce an early warning regime, in the interest of harmonization, it would likely be very similar to that found in the provincial statutes. This would mean the adoption of an "early warning" threshold of 10 percent and a disclosure requirement for any additional 2 percent

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[37] In general terms, alternative reporting would be available only to those persons who do not intend to:

- make a formal bid for securities;
- propose a transaction that would be an exempt take-over bid, in reliance of clause 93(1)(c) of the OSA (the private agreement exemption provision); or
- propose a reorganization, amalgamation, merger, arrangement, or similar business combination with the reporting issuer.

In addition, those to whom alternative reporting is available would only report within 10 days of the end of the month any increase or decrease of 5 percent or more of the outstanding securities of a class held by the person. This contrasts with a 2 percent increase or decrease of ownership, which is to be reported within 2 days of the change, under the standard early-warning disclosure system as specified in section 101 of the OSA. Alternative reporting would not be available if a joint actor with that person or company has any of the above intentions or if the person possesses material information that has not been publicly disclosed.

[38] Under the proposal, a person or company that, either alone or in conjunction with its affiliates, carries on business or investment activity through two or more "business units," (defined as "a legal entity or part thereof, or a combination of legal entities or parts thereof, that engage in a separate and distinct business or investment activity, and may consist of one or more branches of a financial institution") is, with respect to those business units, exempt from aggregating these business units' holdings together for the purpose of early-warning disclosure, if:

- the decisions to acquire, dispose, hold, vote those securities are made separately;
- no person or company of the other business unit also advises with respect to, or has influence over/knowledge of decisions to acquire, dispose, hold, or vote securities for, by, or on behalf of the applicable business unit other than people in senior management or individuals engaged solely in clerical or administrative duties who do not make decisions to acquire, dispose, etc. securities.

acquisition of shares. Any regime would probably also have to reflect any reforms at the provincial level to alleviate some of the burdensome reporting requirements for passive investors.

[47] One problem with implementing such requirements is that they would be largely duplicative. The provincial securities laws already require the collection of this information with respect to publicly traded corporations. Very few additional share acquisitions would be reported under a CBCA early warning regime that are not currently being reported as a result of the provincial securities statutes' requirements.

[48] Only when all the offeree shareholders of a CBCA corporation are located in Prince Edward Island, New Brunswick, the Yukon, the Northwest Territories[39] or outside Canada, would significant share acquisitions escape the provincial early warning requirement. Given the structure of Canadian capital markets, it is unlikely that this would occur since the corporation whose shares are acquired is likely a reporting issuer under a provincial jurisdiction. While a few CBCA corporations currently only issue securities in the United States, and thus would not be subject to the early-warning provisions in provincial securities laws, this is still fairly rare and there would likely be disclosure to United States regulators.[40] It therefore seems burdensome and impractical to introduce and impose another regime on those who are already complying with provincial early-warning requirements, in order to capture a very small group of people which the provincial laws do not capture.

[49] In order to alleviate duplication, the Director appointed under the CBCA could rely on new section 258.2 of the CBCA, when it is proclaimed in force, which will permit the granting of blanket exemptions. More specifically, section 258.2 will allow the Director to issue blanket exemption orders in cases where similar notices or documents are required to be filed under other federal or provincial legislation. Such orders, made with respect to early warning reports, could significantly reduce the number of early warning reports that would be required to be filed with the CBCA Director. Only those acquisitions not currently captured by early warning provisions in provincial securities laws could be made subject to a CBCA early warning regime.[41] In addition,

[39] These are the provinces whose securities laws do not now require early warning disclosure.

[40] These Canadian corporations would be subject to take-over bid rules in the U.S. According to par. 14(d)(1) of the Securities Exchange Act of 1934, if a person, directly or indirectly, becomes the beneficial owner of more than 5 per cent of a class, then a statement must be filed with the SEC. This is a lower threshold than any jurisdiction in Canada.

[41] This would include situations where a CBCA corporation issues securities only in the United States. If the CBCA's take-over bid provisions were eliminated, then these corporations would only be subject to the take-over bid provisions administered by the SEC and not those of Canadian regulators. On the other hand, if the CBCA's take-over bid provisions were kept, then take-overs involving CBCA corporations would be subject to the CBCA's take-over bid rules. While the practice of only issuing securities in the United States is somewhat rare at the moment (internal research found 7 such

introduction of a CBCA early warning regime, combined with the exemption power, would provide a federal presence in the enforcement of early warning violations. However, questions may be raised as to whether it is worthwhile introducing CBCA early warning provisions if the CBCA Director would exempt the vast majority of those who acquire 10 percent or more of a corporations securities.

[50] In Canada, it has generally been felt that acquisitions of securities below the 10 percent threshold are not significant enough, given the closely held nature of Canadian corporations,[42] to warrant early warning disclosure. However, in 1990, the Canadian Securities Administrators requested comments on a proposal to reduce the early warning disclosure threshold from 10 percent to 5 percent "to increase the level of disclosure available to securities regulators and the public."[43] It has also recently been argued that "the identities and stakes of all shareholders holding in excess of 5 percent of the voting shares of Canadian public companies should be disclosed."[44] One of the arguments given for lowering the disclosure level to 5 percent is that the "harsh glare of public scrutiny is the best way to ensure that large shareholders, like the corporations in which they invest, operate in a constructive and responsible a manner."[45]

Recommendation:

[51] It is proposed that the CBCA not be amended so as to adopt an "early warning" requirement.

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corporations), it may become more common in the future.

[42] Please see text accompanying notes 32-33 for statistics on how closely-held Canadian corporations are.

[43] See the "Request for Comments" in the OSCB, vol. 13 (June 1990) at 2295.

[44] Ronald Daniels and Randall Morck, "Canadian Corporate Governance: Policy Options," in Corporate Decision Making in Canada, note 33, p. 690.

[45] Ibid. p. 690.

Options:

[52] (A) Introduce early warning provisions, similar to current provincial rules into the CBCA for distributing corporations[46] and use s. 258.2 exemption orders to deal with duplicative reporting. Also, adopt provisions which would reflect reforms at the provincial level to alleviate some of the burdensome reporting requirements for passive investors.

[53] (B) Introduce early warning provisions as outlined in Option (A) above, however, have an early warning threshold for shareholders holding in excess of 5 percent of the voting shares.

C. DEFINITION OF "ISSUER BID"[47]

Issue:

[54] Whether to provide a separate definition of "issuer bid", which would include the acquisition of any class of the corporation's issued securities.

Background:

[55] Currently the CBCA treats issuer bids as a type of take-over bid, that is, as a change of control situation. However, other regimes consider issuer bids more like a special related party transaction.

[56] In s. 194 of the CBCA, a "take-over bid" is defined as

> "an offer, other than an exempt offer, made by an offeror to shareholders at approximately the same time to acquire shares that, if combined with shares already beneficially owned or controlled, directly or indirectly, by the offeror or an affiliate or associate of the offeror on the date of the take-over bid, would exceed ten percent of any class of issued shares of an offeree corporation **and includes every offer, other than an exempt offer, by an issuer to repurchase its own shares**."(emphasis added)

[46] Currently, the CBCA take-over bid regime applies to distributing and non-distributing corporations with 15 or more shareholders. However, Issue 5(F) recommends limiting the applicability of the take-over bid rules to corporations with 50 shareholders or more (essentially distributing corporations). This limitation would also make sense in the context of an early-warning regime.

[47] Source: OSA, subs. 89(1); BCSA, s. 74.

In addition, s. 194 defines a "share" as "a share carrying voting rights." As such, issuer bid regulation does not currently apply to the repurchase of non-voting shares or other securities.

[57] The policy rationale for regulating issuer bids is applicable to all types of securities. For example, when an issuer makes a bid for its own securities, it could be making the offer based on an information advantage it has relative to its security holders. Alternatively, the issuer could also be making the offer to a select few persons giving them a favourable price. This creates a concern because, if such transactions are allowed to proceed without giving security holders adequate information and time to consider the bid, and without requiring equal treatment, investor confidence in the market could be weakened. Therefore, provincial securities laws define an issuer bid as "an offer to acquire or redeem **securities** of an issuer made by the issuer" [emphasis added].[48]

[58] There may also be concerns about conflict of interest and abuses by corporate insiders. In an issuer bid situation, the potential for abuse applies whether or not the securities carry voting rights. However, it could be argued that the current corporate law rules which apply to issuer bids (but not take-over bids) are adequate to protect shareholders. Fiduciary duties are imposed on the directors and officers and the corporation must meet certain solvency and assets tests.[49] The oppression remedy might also be applicable if the bid is oppressive or unfairly prejudicial to the shareholders, etc.[50]

<u>Recommendation</u>:

[59] That the CBCA provide a separate definition of "issuer bid" that would include offers to purchase, redeem or otherwise acquire any of a corporation's issued securities.

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[48] See for example, OSA, s. 89, definition of "issuer bid" and BCSA, s. 74 definition of "issuer bid." Section 147.19 of the QSA is slightly different. It states that "an issuer who intends to acquire securities issued by him, except debt securities not convertible into securities representing an interest in his share capital, shall proceed by way of an issuer bid." Also note that, effective January 2, 1996, the rules of the Toronto Stock exchange with respect to issuer bids were changed to apply to acquisitions of all listed securities of an issuer and not just equity and voting securities.

[49] See CBCA, s. 122 and subs. 34(2).

[50] See CBCA, s. 241.

D. ISSUER BIDS EXEMPTION[51]

Issue:

[60] Whether to eliminate the application of the private agreement exemption to issuer bids and instead provide an exemption for certain situations where the shareholder has prior notice of either a specific intent to, or the possibility of, repurchase.[52]

Background:

[61] The private agreement exemption in CBCA s. 194 (definition of "exempt offer") states that an exempt offer includes "an offer to fewer than 15 shareholders to purchase shares by way of separate agreements."[53] This exemption is intended to apply to transactions that reflect true bargaining between shareholders and a third party. Provincial statutes do not apply the private agreement exemption to issuer bids.

[62] Private agreement issuer bids create the potential for unfair dealing since the controlling shareholders of the issuer can decide on the purchase and its terms and then sell their shares to the corporation. Also, since a repurchase of shares by the issuer decreases the outstanding equity of the corporation, the controlling shareholders could consolidate their power by increasing the percentage of their holdings. If this repurchase of shares is effected by a private agreement, advance notice need not be provided to other shareholders. Hence, the elimination of the private agreement exemption for issuer bids would limit the potential for inappropriate preferential treatment and could promote the fairer treatment of shareholders.

[63] The provincial securities statutes do provide for exemptions from the issuer bid requirements. Listed below is a compilation of the issuer bid exemptions found in provincial securities statutes:

- where the securities are purchased, redeemed or otherwise acquired in accordance with terms and conditions attached to the securities which allow the issuer to acquire them without the prior agreement of the owners;

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51 New Provision. Source: OSA, subs. 92(3); QSA, ss. 147.20 and 147.21; BCSA, s. 81.

52 CBCA, s. 194, definition of "exempt offer", par. (a).

53 The issue of a private agreement exemption as it applies to take-over bids is discussed in the next issue (Issue 5(E)).

- where the purchases are made to meet sinking fund[54] obligations;

- where the securities carry the right of the owner to require the issuer to redeem the securities;

- where the issuer purchases from current or former employees securities issued in an ownership incentive scheme for employees;

- where the issuer bid is made through the facilities of a recognized stock exchange;

- where the issuer makes normal course purchases of less than 5 percent of the outstanding securities of a class in any 12 month period.[55]

Recommendation:

[64] It is proposed that the application of the private agreement exemption to issuer bids be eliminated. It is also proposed that the CBCA provide issuer bid exemptions similar to those found in provincial legislation. To promote clarity of drafting, both the exemptions as well as the definitions for issuer bids and take-over bids would be set out separately in the CBCA.

E. PRIVATE AGREEMENT EXEMPTION[56]

Issues:

[65] There are three issues with respect to the private agreement exemption.[57] These are whether:

- to reduce the maximum number of shareholders under the private agreement exemption to five, thereby harmonizing the exemption with provincial securities laws;

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[54] Sinking Fund: Money or assets put aside for a special purpose, such as to pay off bonds and other long term debts as they become due or to replace worn-out or out-dated machinery/buildings.

[55] See Issue 5(G).

[56] Sources: OSA, par. 93(1)(c) and subs. 93(2); QSA, ss. 123 and 125; BCSA, par. 80(1)(c).

[57] CBCA, s. 194, definition of "exempt offer", par. (b).

- to limit the ability of shareholders to combine themselves in an attempt to facilitate a private agreement exemption; and

- to limit the premium over market price that can be paid for shares purchased under the private agreement.

Background:

[66] Regarding the first issue, an exemption is provided in s. 194 of the CBCA for an offer "to fewer than fifteen shareholders to purchase shares by way of separate agreements." Generally, at the provincial level, the maximum number of shareholders allowed under a private agreement exemption is five rather than fifteen. If the purchaser has to go to fifteen shareholders in order to obtain control of the corporation, then the corporation is probably fairly widely held and the minority shareholders should receive the protection of the take-over bid provisions. As a result, it has been argued that the provincial limit of five shareholders under a private agreement exemption is more appropriate.

[67] The second issue is that it is possible for groups of shareholders to combine themselves in an attempt to be counted as only one shareholder. In this way, the spirit of the law can be avoided. Examples of this type of activity are the intermediate sale of shares by several shareholders to a single shareholder or the formation of a trust by several shareholders so that the trustee becomes the single legal owner of the shares.

[68] The third issue relating to private agreement exemptions is whether to adopt, as currently found in provincial securities legislation, a maximum premium of 15 percent over market price that can be paid for securities purchased under the exemption.[58] The CBCA does not currently provide any limit and a premium of more than 15 percent can be paid for securities bought under the private agreement exemption. The 15 percent premium limitation is somewhat controversial. Opponents of the limitation argue that there is no rational, theoretical or evidentiary basis for requiring that the control block premium be shared with minority shareholders. These opponents contend that the rule is an unjustifiable deprivation of personal property and point to the prevailing United States position which permits control block premiums. It is also argued that the 15 percent premium limitation may block transactions which would benefit minority shareholders. For example, a change in control may be beneficial in terms of improving the management of the corporation but the controlling shareholder is reluctant to surrender control of the corporation for only a 15 percent premium.[59]

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[58] For example: OSA, par. 93(1)(c); QSA, s. 123; BCSA s. 80.

[59] See Easterbrook and Fischel, "Corporate Control Transactions" (1982) 91 Yale L.J. 698.

[69] Proponents counter that the 15 percent premium limit represents an attempt to balance the interests of minority and controlling shareholders, who typically would be involved in a private agreement. The controlling shareholder is given some flexibility as long as the premium obtained is not "too large." The current belief, as represented by provincial securities statutes, is that a premium limit of 15 percent is "appropriate." Some of this premium may reflect a higher than market price of the underlying stock value that should be realizable by all shareholders. The minority shareholder is protected by the take-over bid provisions if the premium is over 15 percent.

Recommendations:

[70] For the first issue, it is proposed that the maximum allowable number of shareholders under the private agreement exemption be reduced from fifteen to five.

[71] For the second issue, it is proposed that where the offeror knows, or ought to know, that the shareholder with whom he/she is dealing, either:

- acquired the shares from other persons so that the offeror might make use of the exemption; or

- holds the shares for other persons as trustee or other legal representative;

then those other persons should be included in the calculation of the number of shareholders. An exception would be made for testamentary or inter vivo trusts where the beneficial owners have no control over the disposition of the shares.[60]

[72] For the third issue, it is proposed that the CBCA limit to 15 percent the premium over market price that may be paid under the exemption.

F. PRIVATE CORPORATIONS EXEMPTION[61]

Issue:

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[60] See BCSA, subs. 80(2).

[61] Sources: OSA, pars. 93(1)(d) and 93(3)(g); QSA, s. 122; BCSA, pars. 80(1)(d) and 81(1)(g).

[73] Whether to broaden the current "private corporation" exemption provision found in the CBCA.[62]

Background:

[74] Under s. 194 of the CBCA, there is an exemption for offers to purchase shares of a corporation that has fewer than fifteen shareholders. This exemption is inconsistent with that found in provincial securities laws. For example, par. 93(1)(d) of the OSA exempts take-over bids from its regulation if "the offeree issuer is not a reporting issuer, there is not a published market in respect of the securities that are subject to the bid, and the number of holders of securities of that class is not more than fifty. . ." It has been argued that the 15 shareholder threshold is too narrow and that a test similar to that found in the provincial statutes should be used. This argument is based on the belief that offers for shares of a private corporation are usually negotiated thoroughly by the parties involved in the take-over process. It is only when a corporation has more than 50 shareholders do trades become more impersonal and require protection under take-over bid rules.[63]

Recommendation:

[75] It is proposed that the current "private corporations" exemption be broadened so as to resemble that found in most provincial securities laws. Specifically, a CBCA corporation would be exempt from the take-over bid rules if it met all of the following pre-requisites:

- the offeree is not a distributing corporation;
- there is not a published market in respect of the shares that are the subject of the bid; and
- the number of shareholders is not more than fifty, exclusive of shareholders who are or were in the employment of the offeree issuer or of an affiliate.[64]

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[62] CBCA, s. 194, definition of "exempt offer", par. (c).

[63] It should be noted that the CBCA has a 15 shareholder threshold for proxy solicitations. The appropriateness of this threshold is reviewed in the Discussion Paper on Shareholder Communications and Proxy Solicitation Rules (released August, 1995, Issue 6, page 21).

[64] This recommendation would require that the definition of "distributing corporation" found in s. 126 (the insider trading definition part) be moved to s. 2 of the CBCA (the general definition part). This is consistent with the recommendation in the Discussion Paper on Technical Amendments to move common terminology to s. 2.

G. "NORMAL COURSE PURCHASE" EXEMPTION[65]

Issue:

[76] Whether to provide a statutory exemption which would permit the purchase of not more than 5 percent of the shares of a corporation over a period of 12 months (commonly referred to as a "normal course purchase exemption").

Background:

[77] It has been argued that a person can regularly purchase shares issued by a particular corporation without intending to take control of that corporation. Because of this "lack of intent" to take over the corporation, an exemption from the take-over bid provisions is provided by the provincial securities statutes. However, the exemption is only for modest purchases. As such, it allows purchases of not more than 5 percent of the shares of a class in any one-year period. If the size and time limit restrictions are complied with, the take-over bid provisions do not apply even if the normal take-over bid threshold is exceeded.[66] However, disclosure of the purchases to the marketplace is assured through the insider reporting and early-warning disclosure regime.

[78] It should be noted that a 5 percent exemption is currently available indirectly under the CBCA through the interplay of the definition of "exempt offer" in s. 194 and stock exchange rules. The definition of "exempt offer" includes offers to purchase shares through a stock

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[65] Sources: OSA, pars. 93(1)(b) and 93(3)(f); QSA, s. 126; BCSA, pars. 80(1)(b) and 81(d).

[66] Par. 93(1)(b) of the OSA states that a take-over bid is exempt from its take-over bid provisions if, "the bid is for not more than 5 per cent of the outstanding securities of a class of securities of the issuer and,

i) the aggregate number of securities acquired by the offeror and any person or company acting jointly or in concert with the offeror within any period of twelve months in reliance upon the exemption provided by this clause does not, when aggregated with acquisitions otherwise made by the offeror and any person or company acting jointly or in concert with the offeror within the same twelve-month period, constitute in excess of 5 per cent of the outstanding securities of that class of the issuer at the commencement of the twelve-month period, and

ii) if there is a published market for the securities acquired, the value of the consideration paid for any of the securities is not in excess of the market price at the date of the acquisition determined in accordance with the regulations plus reasonable brokerage fees or commissions actually paid."

exchange. Stock exchange rules contain normal course purchase exemptions similar to statutory exemptions found in securities legislation.[67]

Recommendation:

[79] It is proposed that the CBCA be revised so as to provide a 5 percent purchase exemption similar to that found in provincial securities legislation. This would exempt from the take-over bid provisions a purchaser who acquires less than five percent of the shares of a class in any one-year period. Purchases by affiliates and/or associates, including persons or companies acting in concert with the offeror, would be included in the calculation of the 5 percent threshold.

[80] In the case of shares traded on a published market, the value of the consideration paid for any shares acquired must not be in excess of the market price on the date of the acquisition, determined in accordance with the regulations of the exchange plus an allowance for reasonable brokerage fees or commissions actually paid.

H. DEFINITION OF "OFFER"[68]

Issue:

[81] Whether an "offer" should be defined so as to include an acceptance of an offer to sell shares, whether or not the offer was solicited.[69]

Background:

[82] The CBCA defines a "take-over bid" as an "offer" to acquire shares that, if combined with shares already owned or controlled by the offeror, would exceed the level of the threshold. "Offer" is currently defined to include "an invitation to make an offer."

[83] As presently worded, it is unclear if the take-over bid provisions of the CBCA would apply to a situation where an offer is made to acquire less than the threshold number of shares

[67] However, addition conditions are currently imposed by s. 58 of the CBCA regulation which may be narrower in some cases than the normal course purchase exemptions under some exchange rules. The CBCA Director is currently consulting on possible amendments to CBCA Regulations, including s. 58.

[68] Sources: OSA, subs. 89(1); BCSA, subs. 74(1).

[69] CBCA, s. 194.

but, due to the acceptance of an unsolicited offer to sell shares, the number of shares actually acquired exceeds the threshold. Subsection 89(1) of the OSA addresses this possibility by defining an "offer to acquire" to include "an acceptance of an offer to sell securities, whether or not such an offer to sell has been solicited."

Recommendation:

[84] It is proposed that the definition of an "offer" in the CBCA be expanded to include the acceptance of an unsolicited offer to sell.

I. DEFINITION OF "OFFEROR"[70]

Issue:

[85] Whether to clarify the meaning of acting "jointly or in concert" with another person in making a take-over bid.[71]

Background:

[86] The CBCA take-over bid provisions apply where an offer is made for shares that, if combined with shares already owned or controlled by the **offeror**, would exceed the take-over bid threshold. The term "offeror" is defined in s. 194 as:

> a person other than an agent, who makes a take-over bid, and includes two or more persons who, directly or indirectly,
>
> ! make take-over bids jointly or in concert, or
>
> ! intend to exercise jointly or in concert, voting rights attached to shares for which a take-over bid is made.

[87] The CBCA does not define the phrase "jointly or in concert." This can be a problem as disputes can arise over whether two parties have been acting "jointly or in concert" with each other. What relationships and actions would qualify as two persons acting "jointly or in concert"?

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[70] Sources: OSA, subs. 91(1); BCSA, s. 78.

[71] CBCA, s. 194, definition of "offeror."

[88] Section 91 of the OSA states that the following persons are presumed to be "acting jointly or in concert" with an offeror:

- ! Every person or company who, as a result of any agreement, commitment or understanding, whether formal or informal, with the offeror or with any other person or company acting jointly or in concert with the offeror, acquires or offers to acquire securities of the issuer of the same class as those subject to the offer to acquire;

- ! Every person or company who, as a result of any agreement, commitment or understanding, whether formal or informal, with the offeror or with any other person or company acting jointly or in concert with the offeror, intends to exercise jointly or in concert with the offeror or with any other person or company acting jointly or in concert with the offeror any voting rights attaching to any securities of the offeree issuer;

- ! Every associate or affiliate of the offeror.

Other provincial statutes have wording very similar to that outlined above.[72]

[89] Like the above OSA definition, the CBCA probably could not provide a comprehensive definition. However, it may be possible to provide a definition similar to that found in provincial legislation, but that is also more specific as to which relationships would raise a rebuttable presumption that persons are acting in concert. The creation of such a presumption would put potential offerors on notice of their possible obligations and would add a greater degree of certainty, thereby allowing easier enforcement of the CBCA.

Recommendation:

[90] It is proposed that the CBCA be amended to include a rebuttable presumption that persons having certain relationships with the offeror are acting jointly or in concert. This would entail adding a definition of "acting jointly or in concert" that would be similar to the one found in s. 91 of the OSA.[73] In addition, it is proposed that:

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[72] See: ASA, s. 131.1; BCSA, s. 78. Section 111 of the QSA has a different definition of "acting jointly in concert."

[73] If the CBCA does adopt wording similar to s. 91 of the OSA, then it would be necessary to remove the reference to affiliates and associates from the CBCA definition of "take-over bid." The reference in the definition of "take-over bid" would be duplicative because affiliates and associates would be part of the definition of "acting jointly or in concert" with an offeror.

- a person would be presumed to be acting jointly or in concert with an offeror if that person manages the offeror's employee pension fund or the pension fund of the offeror's affiliates and associates; and

- any person who manages investments for another person on a discretionary basis would be deemed to be acting in concert with that other person.

J. EXPANDING MINIMUM BID PERIOD AND OTHER TIME PERIOD RELATED ISSUES

Issues:

[91] Whether to:

- extend the minimum bid period;

- harmonize the other time limits with those in provincial securities laws; and

- eliminate certain distinctions between a "bid for all the shares" and a "bid for less than all shares."[74]

Background:

[92] Some difficulties are created for CBCA corporations because provincial securities laws and the CBCA do not specify the same time limits. For example, par. 197(a) of the CBCA currently provides a minimum 10 day period during which deposited shares may be withdrawn by offeree shareholders. Provincial securities laws provide a minimum period of 21 days.

[93] Other difficulties may arise for CBCA corporations and their directors because the statutory periods may be too short to allow them to adequately analyze a hostile bid, make recommendations to shareholders and/or seek competing bids, in accordance with their fiduciary duties. Minimum deposit periods are also required to ensure that shareholders have sufficient time to consider both the initial bid as well as any competing bids which may arise. In this way, the minimum deposit periods help to achieve one of the main goals of take-over bid regulation - protecting the interests of shareholders. However, extending the deposit period may have a deterrent effect on take-over activity as it would increase the uncertainty faced by a bidder and would enhance the likelihood of a competing bid.

[74] Sources: OSA, s. 95; QSA, ss. 147.3 to 147.10; BCSA, s. 87.

[94] In 1990, the Canadian Securities Administrators proposed extending the minimum bid period from 21 days to 35 days, extending the period for withdrawing securities from 21 days to 35 days, and allowing directors of the target corporation 21 days instead of 10 days to respond to the take-over bid in the directors' circular.[75] In September 1995, the Ontario Teachers' Pension Plan Board carefully reviewed the origin of and rationale for the minimum bid period, the U.S. experience, current difficulties with the period and the related issue of shareholder rights plans. The Board recommended that the provincial securities laws and the CBCA be amended to extend the minimum bid period from 21 to 35 days.[76] More recently, the Investment Dealers Association of Canada established an Ad Hoc Committee on Take-over Bid Time Limits. In early January 1996, the Committee issued a Request for Submissions which identifies the major factors that impact on take-over bid time periods and seeks submissions from interested parties.

[95] The case for increasing the minimum deposit periods is bolstered by the increased use of poison pills/shareholder rights plans in Canada.[77] The stated objective of poison pills is to extend the standard 21 day period that shareholders have to consider a bid.[78] However, these plans are alleged to have also been used to entrench existing management as only bids approved by management tend to escape the application of the poison pill. If the minimum deposit period in the CBCA is made longer, the main argument presented to shareholders for implementing a poison pill - to give them sufficient time to consider the bid - would be weakened.

[96] Fairvest Securities Corporation (Fairvest) recently surveyed its membership with respect to poison pills.[79] Of the 40 clients surveyed, 27 responded. Nine of the 27 respondents had a policy of voting against all poison pills. However, when asked to identify their preference with respect to the optimum minimum deposit period, they responded as follows:

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[75] See the "Request for Comments" in the OSCB, vol. 13 (June 1990) at 2295.

[76] Ontario Teachers' Pension Plan Board, "Submission by the Ontario Teachers' Pension Plan Board Re: Take-over Bid Rules and Shareholder Rights Plans -- A Matter of Time" September 1995, pages 26 and 31.

[77] Fairvest Securities Corporation reported that "the 1995 Canadian proxy season saw over 50 Canadian companies submitting rights plans to shareholders for confirmation at their annual meetings, compared to approximately a dozen in 1994." See McCall, Catherine R., "Poison Pills - The 1995 Proxy Season", Corporate Governance Review, Vol. 7, no. 3, April/May 1995.

[78] It appears that many poison pills extend the deposit period to 60 days. See: "Tembec shareholders OK rights plan", The Financial Post, June 29, 1995, p. 16. There is some evidence for the 60-day standard, but poison pill conditions continue to evolve and change annually.

[79] Mackenzie, William, "Governance News", Corporate Governance Review, Fairvest Securities Corporation, June/July 1995, pp. 12-13.

21 days	0	responses
30 days	2	responses
45 days	13	responses
60 days	10	responses
other	4	responses[80]

The above survey indicates that institutional investors support extending the minimum deposit period. However, this support, according to Fairvest, is likely based on the hope that a longer minimum deposit period will reduce support for poison pills.

[97] In the CBCA different provisions are provided for a "bid for all shares" (s. 195) and a "bid for less than all shares" (s. 196). One particular difference is the time limits for various activities. Some of these differences are outlined below:

		For All Shares	Partial
a)	Maximum time period allowed after take-over bid date for deposit of shares[81]	No limit	35 days
b)	Minimum number of days to expire after take-over bid date before offeror can take up shares	10 days	21 days

[98] To expand on the above, in a bid for all shares there is no time limit within which an offeror must take up and pay for deposited shares. However, if shares have not been taken up by the offeror, the shares may be withdrawn by the shareholders at any time after 60 days following the bid date. Thus, a bid for all the shares can remain open for a period of several months and, subject only to the 60 day withdrawal right, the offeror may control the tendered shares throughout this lengthy period. On the other hand, the maximum time period within which shares must be taken up and paid for in a partial bid situation is 49 days after the take-over bid date.[82]

[80] With two indicating a preference for 90 days, one for 50 days and one for 35 days. It should be noted that the total numbers exceed 27. This is because three respondents indicated a preference for both 45 and 60 days, and one respondent did not make any indication.

[81] "Deposit of shares" is the term used in the CBCA for the action of the offeree tendering their shares to the offeror.

[82] 49 days is calculated by adding the 35 days in par. 196(1)(b) of the CBCA, with the 14 days prescribed in par. 197(b) of the CBCA.

Recommendations:

[99] It is proposed that the minimum bid and deposit periods be extended and that the time distinctions in the CBCA between a "bid for all the shares" and a "bid for less than all shares" be eliminated.[83] As a result, the requirements and time limits would be the same for every bid.

[100] It is therefore proposed that the CBCA's take-over bid time limits (ss. 195, 196, 197) be changed to the following:

- An offeree will be given a minimum of **forty-five** days from the date of the bid to deposit his or her shares;

- Shares deposited pursuant to the bid shall not be taken up by the offeror until the expiration of **forty-five** days from the date of the bid;

- The offeree will be able to withdraw his or her shares at any time before the expiration of **forty-five** days from the date of the bid;

- Directors of the target corporation be given **twenty-one** days from the date of the bid to respond to the take-over bid in the director's circular;

- Shares must be taken up and paid for not later than **ten** days after the expiry of the bid.

- Where the shares have not been taken up and paid for by the offeror, the offeree may withdraw the shares after **fifty-five** days from the date of the bid.

It should be noted that these time periods are not in harmony with those contained in provincial securities statutes. In particular, the recommended deposit period of 45 days is significantly longer than the 21 days found currently in the provincial laws.

K. NOTICE OF WITHDRAWAL OF TENDERED SHARES[84]

[83] There will continue to be a distinction with respect to the following areas: (1) the provision found in par. 195(c) that requires, with respect to a bid for all the shares, that the offeror indicate if he or she intends to invoke the right under s. 206 (compulsory acquisitions); and (2) the provision found in par. 196(c) that requires the offeror, in a partial bid situation where more shares are deposited than desired by the offeror, to take up and pay for shares rateably.

[84] New Provision. Sources: OSA, subs. 95(6); QSA, s. 147.5; BCSA, par. 87(f).

Issue:

[101] Whether to specify the requisite procedure for acceptable withdrawal of deposited shares.[85]

Background:

[102] Currently, following the date of a take-over bid, the CBCA provides a minimum period during which any offeree shareholder may withdraw his or her tendered shares.[86] Unfortunately, the CBCA does not specify the steps required for an acceptable withdrawal, thereby creating the possibility for disputes to arise between the offeror and the shareholder as to the definitiveness of the "withdrawal." Disputes of this nature are most likely to occur when there is a competing bid which is more advantageous to the shareholder, but the initial offeror wants to retain all tendered shares.

[103] To resolve this problem, the provincial securities statutes require shareholders to provide a notice of withdrawal. For example, the BCSA states in par. 87(f):

> Notice of withdrawal of any securities under paragraph (d) shall be made by or on behalf of the depositing securityholder by a method that provides the depository designated under the bid with a written or printed copy and, to be effective, the notice must be actually received by the depository and, where notice is given in accordance with this paragraph, the offeror shall return the securities to the depositing securityholder.

The CBCA could be amended to include a similar provision. If this was done, it would minimize disputes between offerors and shareholders. In addition, it would provide a clearer set of rules detailing the procedure for withdrawal of shares.

Recommendation:

[104] It is proposed that the CBCA require the offeree to provide the offeror's depository with a written, printed, or electronic copy of the notice of withdrawal. When the notice is given, the offeror would be required to relinquish the shares.

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85 CBCA, par. 197(a).

86 CBCA, subs. 198(2).

L. SHARES SOLD BY OFFEROR DURING BID[87]

Issue:

[105] Whether to prohibit, during the period of the bid, the sale by the offeror of any shares of the class sought under the bid.

Background:

[106] The CBCA deals with the purchase, but not the sale, of shares of the target corporation during the bid period. Currently, under the CBCA, an offeror can sell accumulated shares and profit from inflated market prices. Alternatively, the offeror could attempt to tender his/her acquired shares to a competing bidder, thereby further increasing the possibility of profiting from existing market conditions.

[107] The sale of shares by an offeror is likely where the offeror has decided to abandon the bid. In these circumstances, the offeror is essentially trading with undisclosed material information and is insider trading. If the sale is permitted before the bid is withdrawn, the offeror can profit from market prices which have been stimulated by the bid. The offeror could also tender to the competing bidder, whereas the offeree shareholders who tendered to the original offeror may not be able to accept the competing bidder's offer if the withdrawal period has passed.

[108] Profiting from the offeror's own stimulation of the market price could be viewed as a form of market manipulation. Similarly, tendering to a competing bidder while preventing offeree shareholders from doing so could be viewed as unfair.

[109] As a result of the above, Canadian securities laws tend to prohibit sales during a take-over bid. An offeror is not allowed to make or enter into any agreement, commitment or understanding to sell any securities of the class subject to the bid on and from the day of the announcement of the offeror's intention to make the bid until its expiry date. An exception is provided when the offeror discloses in the take-over bid circular his or her intention to sell the shares during the bid.

[110] An argument against adopting this type of restriction is that identifying potential target corporations may be costly and, unless these cost can be recouped, bidders may be reluctant to spend resources to identify targets and make bids. The identity of a target corporation may be an important piece of information. Subsequent bidders may have lower information costs because they do not have to identify the target out of perhaps numerous potential targets. They may, therefore, be able to outbid the first bidder and still make a profit. Take-over bid legislation

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[87] New Provision. Sources: OSA, subs. 94(8); QSA, s. 143; BCSA, s. 86.

preserves some incentive to search for potential targets by giving the bidder an opportunity to obtain and profit from a toe-hold position (currently up to ten percent under the CBCA) without triggering the take-over bid requirements. In order to avoid deferring take-over bids, it may also be important to not unduly restrict the offeror's ability to sell shares to a competing bidder.

Recommendation:

[111] It is proposed that the sale by an offeror of any shares of the class sought under the bid be prohibited during the period of the take-over bid. However, an exception would be provided when the offeror discloses, in the take-over bid circular, his or her intention to sell specific types and numbers of shares during the bid. After the expiry of the bid period, the unsuccessful bidder could tender his or her shares to the successful bidder.

M. NOTICE OF CHANGE IN INFORMATION: CIRCULARS[88]

Issue:

[112] There are two issues with respect to changes in circulars. These are whether:

! to require in the CBCA a notice of change in information to be delivered to offerees where a change has occurred in the information contained in a take-over/issuer bid or directors' circulars; and

! to allow offeree shareholders to withdraw their shares at any time before the expiration of ten days from the date of a notice of change.

Background:

[113] The CBCA does not provide for a formal notice of change of take-over bid circulars. The only requirement found in the CBCA Regulations is that the offeror amend his or her take-over bid circular if there is any material statement in the circular that is discovered to be misleading or

[88] Sources: OSA, par. 95(4)(ii), subss. 98(2), 98(3), and 99(6); QSA, ss. 130, 131, 132, 138, 139, and 147.5; BCSA, subss. 90(2), 90(3), and pars. 91(6)(a), and 91(6)(b).

that has become misleading by reason of events subsequent to the date of the circular.[89] A similar rule exists concerning the director's circular.[90]

[114] The absence of clear rules in the CBCA can lead to a poor and possibly inaccurate information flow to the offeree's shareholders. As a result, capital markets can be hampered. A key element of a take-over bid regime should be to ensure that accurate information is given to offeree shareholders.

[115] Provincial securities laws require a notice of change when the change in the information contained in a circular could reasonably be expected to affect the decision of offeree shareholders to accept or reject the bid. This requirement is broad enough to include misleading information, a change in the facts, and so on.

<u>Recommendations</u>:

[116] It is proposed that the CBCA be amended to require the delivery of a notice of change where a modification has occurred in the information contained in a take-over bid/issuer bid or directors' circular (or a previous notice of change). This would only be required if the change could reasonably be expected to affect the decision of offeree shareholders to accept or reject the bid.

[117] It is also proposed that the CBCA be amended to permit deposited shares to be withdrawn at any time before the expiration of ten days from the date of a notice of change of information in a take-over bid/issuer bid circular.[91]

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[89] CBCA regulations, subs. 67(2).

[90] CBCA regulations, subs. 69(3).

[91] The withdrawal period would not be extended as a result of a notice of change of information in a directors' circular. Otherwise, the directors of the target corporation would have the power to extend the take-over bid period indefinitely by making changes to the directors' circular.

N. NOTICE OF VARIATION: TERMS OF BID[92]

Issue:

[118] Whether to require, in the CBCA, that a notice of variation be delivered to offerees where there is a change in the terms of the bid, and whether a 10-day extension from the time of the notice should be provided for deposit and withdrawal.

Background:

[119] The CBCA does not deal with a variation in the terms of a bid. However, a minimum level of fairness would seem to indicate that offeree shareholders should be provided with a written notice of variation. With some exceptions, shareholders could also be provided with time to reconsider the bid. The exceptions could be limited to when:

- the variation is very easy to assess or is unlikely to affect the shareholders' decision; and
- the variation is merely an extension of the length of the bid.

Recommendation:

[120] It is proposed that the CBCA be amended to require that when a bid has been varied by a change in its terms, the offeror is required to send a notice of variation to every person who has been sent the take-over/issuer bid circular but whose shares have not been taken up and paid for at the date of the change.[93]

[121] The information to be contained in a notice of variation would be prescribed by regulation. It would likely include:

- a description of the change in the terms of the bid;
- the date of the change;

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[92] New Provision. Sources: OSA, subss. 98(4), 98(5), and 98(6); QSA, ss. 130, 131, 138, 147.5 and 147.8; BCSA, subss. 91(6), 92(1), 92(2) and 92(3).

[93] Under par. 197(d) any increased consideration would have to be paid to those whose shares are already taken up.

- the date up to which shares may be deposited and taken up by the offeror; and

- the rights of withdrawal that are available to the shareholders.

[122] If there was a variation, shares could be deposited or withdrawn during the 10 days following the notice of variation. This would be subject to the following three exceptions:

- when the shares have been taken up and paid for by the offeror at the date of the notice;

- when the variation consists solely of an increase in price and/or the time for deposit is not extended for more than 10 days; and

- when the variation consists solely in the waiver of a condition in the bid where the consideration offered for the shares consists solely of cash.[94]

O. INTEGRATION PERIODS[95]

Issue:

[123] Whether to provide pre-bid and post-bid integration periods.

Background:

[124] A pre-bid integration period generally requires that the offeror pay the same or higher price for shares purchased during the take-over period as was paid for the same class of shares during a period before the take-over bid. A post-bid integration period prohibits the offeror from offering a higher price than the bid price for a specified period following the take-over bid.

[125] The purpose of these integration periods is to ensure equal treatment for all shareholders by preventing holders of large blocks of shares from obtaining a premium price for their shares.

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[94] It is proposed that these exceptions, because of their important nature, be placed in the CBCA and not in the Regulations.

[95] New Provision. Sources: ASA, subs. 134.1(2); BCSA, subs. 85(1); MSA, subs. 85(5); NSSA, subs. 100(5); NSA, subs. 95(5); OSA, subss. 94(5) and 94(6); QSA, s.142.1; SSA, subs. 103(6).

[126] The CBCA only provides for integration during the take-over bid deposit period. Paragraphs 197(d) and 197(f) of the CBCA provide that, if an offeror purchases shares independently, the same price must be offered to all shareholders pursuant to the take-over bid.

[127] There has been some concern about the potential premiums paid in private purchases when these acquisitions occur close to public bids. Sometimes, under private purchases, holders of large blocks of target shares are able to secure, or at least are perceived to be able to secure, some advantage in terms of price or the percentage of shares taken up. Provincial securities statutes have integration provisions to ensure that no such advantage is available.

Recommendations:

[128] It is proposed that the CBCA be amended to include a pre-bid integration period like that found in the provincial statutes. Where a take-over bid is made by an offeror and, within the period of 90 days immediately preceding the bid, the offeror acquired shares subject to the bid, the offeror shall:

- offer a consideration at least equal to what was paid under the prior transaction for shares of the same class subject to the bid; and

- offer to acquire under the bid the same percentage of shares of the class subject to the bid that were acquired from a seller in a prior transaction.

[129] It is also proposed that the CBCA be revised to include a post-bid integration period prohibiting, for twenty days following the expiry of the bid, the purchase of the same class of shares for a price that is not generally available to all shareholders.[96] This provision would be similar to that found in provincial legislation.

[96] A 20 day period has been chosen in the interest of harmonization with provincial security laws provisions.

P. COMPELLED ACQUISITIONS[97]

Issue:

[130] Whether to amend the CBCA to give minority shareholders the right in certain circumstances to compel the corporation to purchase their shares.[98]

Background:

[131] The offeror who acquires 90 percent of the outstanding shares of a class is granted under CBCA subs. 206(2) a right to acquire the remaining shares. This acquisition right obliges non-tendering shareholders to sell their shares and permits the majority shareholder to "take the corporation private." However, the CBCA does not address the concern that, if the offeror decides not to take up their shares,[99] some shareholders may be left in an extreme minority position with shares that are no longer listed or are thinly traded. That minority group of shareholders is also unlikely to have any significant influence in the running of the corporation.

[132] Section 189 of the Ontario Business Corporations Act (Ontario BCA) addresses this problem by permitting shareholders in certain circumstances to compel the corporation to purchase their shares. Whereas section 188 provides to majority shareholders the right to buy out the minority, section 189 enables minority shareholders to demand to be bought out, not by a majority shareholder but by the company. The value offered is set by the corporation or may be fixed by a court.

[133] Compelled acquisitions, or at least the potential for them, may raise concerns for corporations. The expense of sending out a notice as prescribed by the Ontario BCA can be significant and the frequency of such mailings is also an issue. The sheer burden of the capital expenditure necessitated by a compelled acquisition may have serious financial ramifications.

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[97] New provision. Sources: Ontario Business Corporations Act (Ontario BCA), s. 189.

[98] This issue is also considered in the CBCA Discussion Paper on Going-Private Transactions released August, 1995, Issue 5, pages 21-2.

[99] Or a majority shareholder acquires 90% of the shares through an exempt transaction or there is an existing 90% shareholder.

Recommendation:

[134] It is proposed that the CBCA by amended, in terms similar to s. 189 of the Ontario BCA,[100] to give minority shareholders the right to require the corporation to purchase their shares if a majority shareholder owns or controls more than 90 percent of the shares of the corporation.

Option:

[135] Maintain the status quo and not amend the CBCA to permit compelled acquisitions.

Q. THRESHOLD FOR COMPULSORY ACQUISITIONS[101]

Issue:

[136] Whether to amend the CBCA to lower the threshold for compulsory acquisitions by majority shareholders, from the current 90 percent of shares not held by the offeror to 90 percent of the shares of that class, and to permit a majority shareholder to exercise the right without having made a takeover bid.[102]

Background:

[137] One difficulty offerors currently may have with using subs. 206(2) of the CBCA centres around the phrase "other than the shares already held. . ." This wording means that even if the offeror already holds 89 percent of a class of shares, he or she must obtain 90 percent of the remaining 11 percent of shares in order to resort to subsection 206(2). This makes the use of subs. 206(2) more difficult. If the above mentioned wording were removed, then the offeror would only have to acquire the percentage of remaining shares that would give him or her 90 percent or more of all the shares of a class, in order to exercise the right provided by subs. 206(2). This would make the use of the acquisition right in subs. 206(2) more frequent.

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[100] As under Ontario BCA s. 189, the corporation would be required to notify all minority shareholders of their right to compel it to buy their shares.

[101] New provision. Sources: Ontario BCA, s. 189.

[102] This issue is also considered in the CBCA Discussion Paper on Going-Private Transactions released August, 1995, Issue 7, pages 25-6. That paper discusses whether the s. 206 threshold should be reduced to 67% to match the threshold generally imposed for going-private transactions.

[138] Similarly, a majority shareholder may currently hold greater than 90 percent of the shares of a class but is not permitted to make use of the compulsory acquisition right unless a takeover bid is made and 90 percent of offerees accept the bid. The section could be redrafted to permit such a majority shareholder to exercise the compulsory acquisition power without having made a take-over bid. A majority shareholder may have had the 90 percent shareholding for some time, or have acquired 90 percent or more of the class of shares through an exempted transaction (for example, an exempted private agreement).

[139] However, the right of compulsory acquisition is an extraordinary one, granting one private party the power to essentially expropriate the private property of another private party. Moreover, the requirements that there be a take-over bid and that the bid is accepted by 90 percent of the offerees helps ensure that the price of the compulsory purchase is fair. If 90 percent of the offerees accept the bid, there can be some assurance that the price is fair. Section 206 does provide a mechanism for minority shareholders to dissent and have a court set a "fair price." This and other fairness mechanisms could be built into a revised section 206 to help ensure fairness for minority shareholders. Many of these fairness issues are canvassed in the Industry Canada Discussion Paper on Going-Private Transactions, released August 1995.

Recommendation:

[140] It is recommended that the CBCA not be amended and that s. 206 continue to require an offeror to acquire 90 percent of the shares not held by the offeror. Any enhanced mechanism for majority shareholders to eliminate the minority should be considered in the context of Going-Private Transactions, the subject of another discussion paper.

Options:

[141] (A) Remove the phrase "other than the shares already held" from subs. 206(2) of the CBCA so as to permit an offeror, holding 90 percent of the shares of a class, to acquire remaining shares.

[142] (B) Redraft s. 206 to permit a shareholder with more than 90 percent of the shares of a class to acquire the remaining shares (whether or not a take-over bid has been made).

R. EXEMPTION FROM TAKE-OVER BID PROVISIONS[103]

Issue:

[143] Whether to authorize the CBCA Director to grant exemptions from any of the provisions of Part XVII of the CBCA (take-over bids).

Background:

[144] The take-over bid part of the CBCA, Part XVII, is one of the areas over which the Director is not given the power of exemption. Presently, under s. 204 of the CBCA, an interested person may apply to a court to make an order exempting a bid from any of the take-over bid provisions.

[145] This places a burden on the courts and may be expensive for applicants. Furthermore, by giving the power to grant exemptions to the CBCA Director, who has expertise in this area, more expeditious and less costly proceedings can be expected.

[146] Consideration may be given to whether the Director's exemptive relief capacity should be given only on a case by case basis or whether blanket orders could be issued. The ability to issue blanket orders exempting, for example, offerors who comply with another approved regime, could permit the CBCA Director to deal with most, if not all, cases of regulatory overlap.

Recommendation:

[147] It is proposed that the Director be given the power to grant both case by case and blanket exemptions from any provisions of Part XVII of the Act. This power would, like the other exemption powers of the Director, be subject to judicial review under s. 246.

[103] New Provision. Sources: ASA, par. 144(2)(c); BCSA, par. 96(2)(c); MSA, par. 95(2)(c); NSSA, par. 110(2)(c); NSA, par. 105(2)(c); OSA, par. 104(2)(c); QSA, s. 263; SSA, par. 113(2)(c).

S. CONVERSION OF BID-FOR-ALL TO PARTIAL BID[104]

Issue:

[148] Whether to prohibit the conversion of a bid for all shares to a bid for less than all shares.[105]

Background:

[149] Under the CBCA, an offeror is permitted to convert a bid for all shares to a partial bid, which would then be governed by the rules governing partial bids. The protection of minority shareholders is a concern when a bid for all shares is changed to a partial bid. Upon conversion to a partial bid, the offeror could simply retain shares purchased up to that point, thereby ignoring other shareholders whose shares have not been tendered. This process may put some shareholders at a distinct disadvantage.

Recommendation:

[150] It is proposed that when a bid for all shares becomes a partial bid, it must be accompanied by a new set of terms and conditions. By establishing this procedure, the rights of minority shareholders would be protected because a notice of variation in the terms of the bid would have to be circulated and a 10-day withdrawal/extension would be provided to shareholders.

Option:

[151] Alternatively, the CBCA could prohibit the conversion of a bid for all shares of a class into a bid for less than all shares of the class. If the offeror decides to do this, a new take-over bid must be made.

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[104] New Provision.

[105] CBCA, subs. 196(2).

T. PROVIDE TAKE-OVER BID INFORMATION TO NON-RESIDENTS

Issue:

[152] Whether to require the dissemination of take-over bid information to shareholders outside of Canada.[106]

Background:

[153] Sections 198 and 201 of the CBCA state that only shareholders who are Canadian residents shall be sent take-over bid and director's circulars. "Shareholders in Canada" is defined in subs. 198(3) of the CBCA. It states that "a shareholder of an offeree corporation is deemed to be resident in Canada if his latest address as shown in the securities register of the offeree corporation is an address within Canada."

[154] During the preliminary round of consultations, some stakeholders argued that all shareholders should be sent take-over bid information. This is in-line with the underlying principle of the CBCA which states that all shareholders should be treated equally. As the CBCA is currently worded it treats more favourably those shareholders who reside in Canada. As a result, foreign investors who invest in CBCA corporations may not be informed of a take-over bid. This may hinder Canada's capital markets by making foreign investors more cautious about investing in CBCA corporations.

[155] On the other hand, offerors and corporations would have to incur the additional cost of ensuring shareholders resident outside Canada receive the take-over bid information and that the offers comply with the foreign jurisdiction's requirements, most notably those of the United States. The cost of doing this could be prohibitive and/or be out of proportion to the number of shareholders in the foreign jurisdiction. In addition, the requirement to disseminate take-over bid information to non-residents of Canada would expose the sender to potential litigation for not having met the disclosure requirements of the countries to which the material is sent. At this time, it is not evident that the increased hindrance to capital markets would outweigh the higher dissemination costs and elevated litigation risk.

[156] The provinces and the United States have agreed to a Multi-Jurisdictional Disclosure System (MJDS).[107] The take-over bid part of this system allows corporations to disseminate take-over bid information to shareholders in the other country while only having to comply with their

[106] Only Canadian residents receive takeover bid and director's circulars - CBCA, subss. 198(1), 198(2), and s. 201.

[107] See National Policy No. 45 of the Canadian Securities Administrators.

native jurisdiction's take-over bid disclosure requirements. This significantly reduces the costs of dissemination and the litigation risk.

Recommendation:

[157] At this time the CBCA should not be amended to require that take-over bid information be disseminated to non-residents of Canada.

Option:

[158] Amend the CBCA to require information be sent to shareholders who reside jurisdictions with whom a MJDS agreement exists.

U. CHANGE FRENCH EXPRESSIONS TO THOSE MORE COMMONLY USED

Issue:

[159] Whether some of the French expressions in the take-over bid provisions of the CBCA should be changed to correspond to those used in the QSA and elsewhere.

Background:

[160] The French version of the CBCA uses the expression "offre d'achat visant à la mainmise" for a "take-over bid." Other provinces (New Brunswick, Manitoba, Ontario) have followed the CBCA's French terminology in their securities and corporate laws.

[161] However, the QSA uses the expression "offre publique d'achat" instead of "offre d'achat visant à la mainmise." The expression "offre publique d'achat" is commonly used by commentators, and is also utilized in European countries including France.

[162] The CBCA terminology causes problems for an offeror who makes an offer to acquire shares of a CBCA corporation whose shareholders are located in the province of Québec.[108]

[108] The take-over bid rules of the CBCA concern bids made anywhere in Canada to shareholders of CBCA corporations (s. 194). However, a take-over bid is subject to a provincial securities law when the offer is made to a person or company in that province, or to any security holder of the offeree issuer whose last address as shown on the books of the latter is in the province (OSA, subs. 89(1), QSA, s. 113, BCSA,

Practitioners who prepare a take-over bid in French have to use two different terms for "take-over bid." Harmonization of the CBCA with the more commonly used expression of the QSA would avoid this duplication of terminology and would be less burdensome for CBCA offeror corporations.

[163] In addition, if the CBCA take-over bid provisions no longer apply to private corporations as recommended in Issue 5(F), the term "offre publique d'achat" can be used. It could not be used if the CBCA continues to apply its take-over bid provisions to private companies because an offer for the shares of a private company with more than fifteen shareholders is not "publique."

[164] Some other French expressions used in the CBCA's take-over bid provisions are no longer the terms used in the QSA or by the media. Outlined below are some of the French expressions currently used by the CBCA, the proposed "new" expressions which could replace the old ones, and the corresponding English version of these expressions.

	CBCA Expression	New Expression	English
!	Pollicitant	Initiateur	Offeror
!	Pollicité	Porteur de titres de la catégorie visée	Offeree
!	Société pollicitée	Société visée	Offeree corporation

Recommendation:

[165] Amend the CBCA by replacing, in the French version, the expression "offre d'achat visant à la mainmise" with "offre publique d'achat." It is also recommended that the other "new" French expressions listed above should replace those currently used in the CBCA's take-over bid provisions.[109]

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subs. 74(1)).

[109] The CBCA Discussion Paper on Technical Amendments (released September, 1995), also discusses modernization of the securities terminology used in the CBCA (Issue 4, page 6).

V. LEVERAGED BUY-OUTS[110]

Issue:

[166] Whether leveraged buy-out take-over bids should be specifically regulated under the Part XVII in order to protect creditors and minority shareholders.

Background:

[167] A leveraged buy-out (or LBO) is a transaction whereby the purchaser of a corporation uses the assets of that corporation to finance the acquisition.[111] One author has noted some concerns that have been raised about leveraged buy-outs:

> While large-scale take-overs such as that of RJR Nabisco raised the public profile of LBO's, the highly publicized financial difficulties caused to Allied Stores Corp. and Federated Department Stores Inc. by Campeau Corporation's takeover have demonstrated the serious consequences that can be caused to the target corporation when its assets are leveraged to the point where it exceeds the ability of the corporation to generate sufficient revenue to carry the debt.[112]

[168] On the other hand, it can be argued that leveraged buy-outs make possible more take-over bids, thereby benefiting shareholders, who are offered an opportunity to sell their shares at a premium, and potentially serving other corporate stakeholders, who may benefit from improved management.

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[110] New Provision.

[111] A recent example of a proposed LBO is the May 1995 takeover bid of Chrysler Corporation made by Kirk Kerkorian. The $22 billion (U.S.) bid depended on $13 billion in borrowed funds, $5.5 billion from the target company, Chrysler Corporation, and only $3.5 billion from the bidders. See "Kerkorian pulls offer for Chrysler," Globe & Mail (June 1, 1995) B1.

[112] Nicholas Dietrich, Working with the Ontario Business Corporations Act: The Practitioner's Experience, The Law Society of Upper Canada, Department of Continuing Education, Toronto, 1989, at p. 2. More recently, Frederick Toole in "Financial Assistance by Corporations [:] S. 43 Business Corporations Act (N.B.)" in New Brunswick CLE Corporate Law Conference (September 14, 1990) at page 1.

[169] Leveraged buy-outs are not directly regulated under the CBCA or provincial securities laws. However, certain CBCA provisions impact on this issue. Section 199 of the CBCA currently requires an offeror to make "adequate arrangements to ensure that funds are available to make the required money payment" for the shares deposited during a take-over bid.[113]

[170] This provision, when first adopted in federal business corporate law in 1970, was based on a provision in OSA (now s. 96). Section 96, while using different language, imposes essentially the same requirement. The materials prepared for Parliament explaining the policy rationale for the 1970 amendment to federal business corporate law stated that: "This section, practically speaking, bars any take-over bid made conditional upon the offeror obtaining the required funds at a subsequent date."

[171] As far as we are able to determine, s. 199 has not been interpreted by the courts in respect of any proposed leveraged buy-out and in relation to whether use of the target corporation's funds might be seen as "an adequate arrangement."[114] The case law seems to focus on whether the

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[113] Section 199 of Part XVII (Take-over Bids) specifically provides: "Where a take-over bid states that the consideration for the shares deposited pursuant thereto is to be paid in money or partly in money, the offeror shall make adequate arrangements to ensure that funds are available to make the required money payment for such shares."

[114] One reported case interpreting s. 199 found that an offeror had failed to comply with this provision where the circular only referred to the financial arrangements for one of several possible outcomes of the bid (the bid was for 50.1% of the shares but the bid included an option for the offeror to take up more than 50.1%): see Re Calgary Power Ltd. and Atco Ltd. (1980), 115 D.L.R. 625 (Alta Q.B.). Financing of the bid through target corporation assets was not at issue. A second reported case, Nalcap Holdings Inc. c. Kelvin Energy Ltd., [1988] R.J.Q. 2768 (C.S.), is discussed below.

shares to be purchased will be paid for, not the arrangements following the take-over bid.[115] Therefore, adequate bridge funding from a bank, followed by financial assistance in the form of loans or guarantees from the target corporation after the purchase, may be acceptable under s. 199, although there is no authority on this point.

[172] Another relevant CBCA provision is s. 44 which places certain restrictions on financial assistance for share purchases. Another CBCA Phase II reform discussion paper[116] examines generally the concerns that have been raised with s. 44. However, s. 44 also overlaps with CBCA Part XVII in the area of a leveraged buy-out take-over bid. One of the original reasons given in 1929 for restricting financial assistance for share purchases was to prevent leveraged-buy-outs, which some considered "highly improper" at the time.

[173] The restrictions on financial assistance were adopted, with certain variations, into the CBCA in 1975. One important change was that the CBCA expressly permitted a corporation to give financial assistance[117] to a holding (parent) body corporate "if the corporation is a wholly-owned subsidiary of the holding body corporate."[118] The materials prepared for Parliament explaining the policy rationale for the CBCA provisions gave the following reason for the change:

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[115] In Nalcap Holdings Inc. c. Kelvin Energy Ltd., [1988] R.J.Q. 2768 (C.S.), the court held at page 2773

> The fact that [the offeror] is for all practical purposes insolvent does not bar it from making a take-over bid, provided that it complies with the law and regulations. The purpose of the legislation relating to take-over bids is to safeguard the rights and interests of the shareholders of the offeree corporation, not those of the offeror. . .

The court continued at pages 2775-6 that:

> . . . the offeror must also have made arrangements to ensure that the shareholder tendering his shares will receive payment for them within the delay stipulated in the offer, in this case ten days from the termination of the take-over bid. And the arrangements must be "adequate" for that purpose. The law does not envisage the possibility that a shareholder will be persuaded to tender and deposit his shares in response to a cash take-over bid only to find that the offeror has not arranged the necessary funds to enable him to pay for what he has undertaken to buy.

> . . . no cash take-over bid under Canadian law may be made unless the offeror is in a financial position to pay for what he proposes to purchase, or has made adequate arrangements for this purpose. In this case, [the offeror] is insolvent and has failed to demonstrate that it has ensured that the necessary funds will be available at the time they are needed. The arrangements are not only inadequate, they are non-existent.

[116] CBCA Discussion Paper on Financial Assistance, to be released shortly.

[117] And exempted the transaction from the application of the solvency/assets tests.

[118] CBCA par. 44(2)(c).

"Paragraph (c) has been added to facilitate the borrowing arrangements that are commonly made in today's business world."

[174] It appears that one effect of this change was to nullify one of the original goals of the financial assistance provision, namely the prohibition of leveraged buy-outs.[119] Other than a question of timing,[120] the exemption appears to allow a corporation that purchases all the shares of another corporation to then obtain financial assistance from that wholly-owned subsidiary, including financial assistance for any debt acquired to purchase the subsidiary. In other words, the exemption added in 1975 seems to expressly permit one type of transaction, the leveraged buy-out, that the provision was originally designed to prohibit. However, the section continues to protect minority shareholders from a leveraged buy-out where the take-over bid is not for all the shares. Shareholders are protected but not creditors.

[175] The only two cases decided in this area seem to suggest that leveraged buy-outs do not contravene s. 44.[121] Nevertheless, there remains some concern in the financial and business communities as to the validity of financial assistance for share purchases by the subsidiary.[122]

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[119] In respect of a LBO which is made by a corporation and which results in the purchaser acquiring all the shares of the corporation. A LBO made by an individual would not be exempted.

[120] Timing of financial assistance transactions will be discussed in Appendix C of the CBCA Discussion Paper on Financial Assistance.

[121] Noren v. Brownie's Franchises Ltd. (1987), 37 D.L.R.(4th) 1 (B.C.C.A.), 13 B.C.L.R.(2d) 73, 36 B.L.R. 85 and Straight Line Contractors v. Rainbow Oilfield Maintenance Ltd. (1991), 115 A.R. 327 (Alta C.A.) These cases will be discussed in detail in Appendix C of the CBCA Discussion Paper on Financial Assistance.

[122] Belcher and Lewarne, "Corporate Guarantees as a Form of Financial Assistance: The Banker's View" (1989) 5 Banking and Finance Law Review 10 comment at pages 14-6 that:

> The structure of the prohibition and exemption to the prohibition in . . . section 44 of the CBCA cause practitioners difficulties in . . . transactions under which the availability of the exemption to the prohibition upon financial assistance is dependent upon corporations becoming subsidiaries at the time the transaction is completed. A good example is the structuring involved in takeover situations such as leveraged or management buy-outs when the proposed bank financing of the acquisition contemplates the giving of a secured guarantee by the target company. The timing of the giving of such guarantee is critical and can lead to some concerns that the transaction is a stepped transaction. The concern is that the Court will ignore the very carefully orchestrated sequence of events and simply focus on the substance of the transaction to find that the transaction was prohibited . . .
>
> In a leveraged buy-out situation, the investment banker usually sets out a financing plan involving sequential steps to complete the takeover including the granting of security. In a friendly takeover transaction,

Therefore, in order to avoid the possibility that s. 44 prohibits the financial assistance transaction, the offering corporation which uses a leveraged buy-out often amalgamates with the target corporation. It is notable, however, that the requirements for amalgamations under the CBCA might be seen as more rigorous than they are for financial assistance.[123]

[176] A third CBCA provision, s. 241, granting shareholders and others an oppression remedy, might also be applicable to leveraged buy-outs. It is possible that the granting of loans and guarantees by the target corporation to finance its own acquisition could form the basis of a oppression application if this conduct is seen as unfairly prejudicial to or unfairly disregards the interests of minority shareholders or creditors.[124] The directors of the target corporation are also subject to their fiduciary duties to act in the best interests of the corporation.

Recommendation:

[177] It is recommended that Part XVII not be amended to impose specific rules for leveraged buy-outs.

> the steps are sometimes even set out in agreements or documents called "heads of agreement". In any event, the banking syndicate is often involved in structuring the transaction. The methods and timing of giving of security are often agreed upon in advance of the takeover even being launched. A guarantee to support the purchase of shares is only permissible if the target is a subsidiary of the acquirer because usually the solvency tests cannot be met . . .
>
> Nevertheless, in leveraged buy-out transactions, the issue of the target company's guarantee arises strictly in cases where [the purchaser] and the target company do not undergo [an] amalgamation immediately following the completion of the transaction. Banks, however, usually require the . . . amalgamation approach. This is because of the difficulties with and potential voiding of prohibited guarantees.

[123] Under CBCA s. 185, the articles of amalgamation must be accompanied by a statutory declaration of a director or officer of each corporation that establishes to the satisfaction of the CBCA Director that there are reasonable grounds for believing that each amalgamating corporation and the amalgamated corporation will be solvent, that the amalgamated corporation's realizable assets will not be less than its liabilities and stated capital, and that no creditor will be prejudiced. Under s. 44, the test is a negative one (that there are no reasonable grounds for believing the corporation granting financial assistance is insolvent, etc.), which is presumably more easy to satisfy. Also, s. 44 does not expressly refer to prejudice to creditors. On the other hand, directors' liability is expressly imposed under s. 118 on directors who approve financial assistance contrary to s. 44. There is no similar express liability provision in respect of amalgamations.

[124] We are unaware of any cases that have been decided on this issue.

Option:

[178] Part XVII could be amended to require that, when an offeror makes a leveraged buy-out take-over bid, the offeror, or a director of an offeror which is a body corporate, shall prepare and circulate with the bid a statutory declaration (similar to the declaration required in respect of amalgamations). The statutory declaration shall state that there are reasonable grounds to believe that:

(a) the offeror and offeree corporation are and will be, after the completion of the take-over bid, able to pay its liabilities as they become due;

(b) the realizable value of the offeree corporation's assets will not be less that the aggregate of its liabilities and stated capital of all classes; and

(c) no creditor will be prejudiced by the leveraged buy-out.

W. TAKE-OVER BID FINES AND PENALTIES

Issue:

[179] Whether the fines for non-compliance with the CBCA's take-over bid provisions should be increased.[125]

Background:

[180] The CBCA provides for fines of up to $5,000 and/or imprisonment for a period of up to six months if a person does not comply with the take-over bid provisions (s. 205) or files a report that omits relevant or contains false information (s. 250). These penalties have not been altered since the CBCA's enactment in 1975. There have been suggestions that the CBCA's penalties are inadequate and should at least be raised to a level that reflects the effects of inflation.

[181] The provincial securities laws allow for much higher penalties. The general offence provision of the OSA provides for penalties of up $1,000,000 and/or imprisonment for a period of

[125] CBCA, ss. 205 and 250. Section 205 contains penalties applicable only to the take-over bid provisions. Section 250 is a general offence section that specifies penalties with respect to making untrue statements in reports and/or omitting material information from reports.

up to two years.[126] Most other provincial securities statutes, except Quebec's, have similar penalties for non-compliance with their take-over bid provisions.[127]

[182] The QSA takes a slightly different approach. If a person makes a misrepresentation in the course of a take-over/issuer bid, he/she is guilty of an offence and shall pay a fine of not less than $5,000 and not more than $1,000,000.[128] If a person contravenes the QSA, other than by way of misrepresentation, then the penalties are between $1,000 and $20,000 for a natural person, and $1,000 and $50,000 in other cases.[129]

Recommendation:

[183] The penalties in sections 205 of the CBCA should be increased to a maximum fine of $1 million and/or a period of up to 2 years in jail. The penalties in section 250 should be increased to $100,000 and/or a period of up to 6 months in jail.

6. DEFENSIVE MEASURES

[184] One of the most controversial issues arising in connection with hostile take-over bids concerns the proper role of the target corporation's managers and the tactics they may employ in responding to a hostile take-over bid. Key issues to be considered include:

- maximization of shareholders wealth;
- long-term viability of the corporation;
- interests of non-shareholder constituencies; and
- management conflict of interests.

[185] Numerous defensive measures, with exotic names like poison pills, golden parachutes and white knights, have been developed. The common feature among all defensive measures is that the corporate management, using the broad powers and often huge resources at its disposal, acts to prevent the success of an actual or potential bid. For example, the most common defensive measure, the poison pill, would make it extremely difficult/expensive for a hostile bidder to gain

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[126] OSA, s. 122.

[127] ASA, subs. 161(2); BCSA, s. 138; MSA, s.136; NSSA, s. 131; NSA, s. 122; SSA, s. 131.

[128] QSA, s. 204.

[129] QSA, s. 202.

control of the target corporation without the cooperation of the management of the target corporation.

[186] Several theories[130] have been put forward regarding the use and effect of defensive measures. One theory is that defensive measures are beneficial because they allow managers to focus on the operation of the corporation and manage it with an eye towards the long term. Proponents of this theory believe that the threat of a take-over causes management to be myopic. Current and near-term cash flows are easier to value than distant cash flows, so managers often sacrifice long-term investments and pursue the maximization of current earnings. Adopting defensive measures, it is argued, removes the incentive for management to take a short-term view of their firm and allows them to freely pursue valuable longer-term projects that eventually will be fully valued in the market.[131]

[187] A second theory argues that defensive measures are used by managers to entrench themselves. If past or current decisions cause them to expect that their firm will fall behind their competitors, they may fear a possible take-over. As a result, these managers propose defensive measures with the hope of insulating themselves from outside scrutiny and potential replacement. Most American studies[132] support the theory that defensive measures are used by management, which does not own a controlling interest in the corporation, to entrench themselves when their firms are becoming less competitive and more vulnerable to a take-over bid.

[188] A third theory is that defensive measures are used primarily to increase management's bargaining power in potential take-over negotiations. Increased bargaining power comes from management's increased direct or indirect control over voting rights. Management can use this power to increase shareholder value and/or protect themselves.

[189] Management argues that the chief value of poison pills, the primary defensive measures used today, is that they typically extend the standard 21-day period that shareholders have to consider a take-over bid,[133] thus allowing the corporation more time to find a better offer. Another reason that corporations give for adopting poison pills is that they can help to ensure

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[130] Stangeland, David A., "Why Are Anti-Takeover Devices Being Used?" (1995) Business Quarterly 36; MacIntosh, J.G., "The Poison Pill; A Noxious Nostrum for Canadian Shareholders" (1989) 15 Canadian Business Law Journal 276.

[131] Some studies conducted in the United States have questioned the validity of the management myopia theory: see Romano, note 16.

[132] Ryngaert, M. "The Effect of Poison Pill Securities on Shareholder Wealth" (1988), 20 J. Fin. Econ. 377; Malatesta, P.H., Walking, R.A., "Poison Pill Securities: Stockholder Wealth Profitability and Ownership Structure" (1988), 20 J. Fin. Econ. 347; Stangeland, David A., "Why Are Anti-Takeover Devices Being Used?", Business Quarterly, note 130. We are not aware of any Canadian studies.

[133] Section 197 of the CBCA.

fairness for shareholders (for example, by requiring that a take-over bid be made for all shares). While the proposed extension of the take-over bid period from 21 to 45 days, as recommended in Issue 5(J), could lessen the desire for poison pills in Canada, it remains to be seen whether this will occur. The extended take-over bid period does not address the issue of fairness to all shareholders, another reason corporations give for adopting poison pills. As a result, these defensive measures may continue to be adopted even if the legislated take-over period is extended substantially.[134]

[190] Recently a new generation of poison pill has emerged.[135] Early poison pills were attacked by shareholders as interfering with their decision-making powers and giving too much discretion to management. The new shareholder rights plans have been redesigned to be more acceptable to shareholders, especially institutional investors. For example, many new plans now allow for partial bids, a more equitable calculation of the ownership level of the offeror, and/or exemptions for routine trading by large institutional investors (allowing them to control larger stakes than individuals without triggering the poison pill).

[191] Even if the new generation of poison pills appear to be less objectionable to shareholders, it is important to review the role of management in hostile take-over bid situations. As a result, this paper will examine whether the directors' fiduciary duties should be redefined and/or whether a code of conduct should be adopted.

A. DIRECTORS' FIDUCIARY DUTIES: HOSTILE TAKE-OVER BID

Issue:

[192] Whether the CBCA should be amended to redefine directors' fiduciary duties in the context of a hostile take-over bid.

Background:

[193] The starting point in any review of corporate directors' actions is the statutory provision which sets out the directors' duties. Subsection 122(1) of the CBCA requires a director, in discharging his/her duties, to "act honestly and in good faith with a view to the best interests of

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[134] Mackenzie, W., "Governance News", Corporate Governance Review, Fairvest Securities Corporation, June/July 1995, p. 13.

[135] McFarland, J., "Poison Pills Sweetened for Shareholders", Financial Post, June 23, 1995, p. 1.

the corporation" and to "exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances."

[194] Notwithstanding this formulation, the courts have struggled to coherently define the proper role of directors in defending against a hostile bid. In the take-over bid setting, the English case of Hogg v. Cramphorn[136] stands for the principle that a board of directors may not exercise its power for an improper purpose. The court held that an issuance of shares aimed at defeating an acquisition for control was invalid[137] even though the directors honestly believed that they were acting in the corporation's best interests. Some Canadian judgments, however, have refined this "proper purpose" test by taking a line more favourable to management.

[195] In Teck Corporation v. Millar,[138] Berger J. concluded that it was not "sound to limit the directors' exercise of their powers to the extent required by Hogg v. Cramphorn." Advocating a more lenient "proper purpose" approach, Berger J. stated:

> My own view is that the directors ought to be allowed to consider who is seeking control and why. If they believe that there will be substantial damage to the company's interests if the company is taken over, then the exercise of their powers to defeat those seeking a majority will not necessarily be categorized as improper . . . I think the Courts should apply the general rule in this way: The directors must act in good faith. Then there must be reasonable grounds for their belief. If they say that they believe there will be substantial damage to the company's interests, then there must be reasonable grounds for that belief. If there are not, that will justify a finding that the directors were actuated by an improper purpose.[139]

[196] The principles in the Teck case can be summarized as follows:

- directors have a fiduciary duty to act in the best interests of the corporation and cannot exercise their powers merely for self-entrenchment or for any improper purpose collateral to the interests of the corporation and its shareholders. The primary purpose of the action must be for the best interests of the corporation;

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136 [1967] Ch. 254.

137 The proper purpose in issuing shares is to raise capital.

138 (1972), 33 D.L.R. (3d) 288 (B.C.S.C.).

139 Ibid., p. 315.

- directors are entitled to exercise their powers and take actions to resist a take-over bid where they believe the take-over is not in the best interests of the corporation or that substantial damage would result to the corporation's interests;

- in assessing the best interests of the corporation, the directors may consider:
  - who is seeking control and why (assess the reputation of the offeror, previous experiences with the offeror, policies of the offeror, etc.);
  - the interests of employees and consequences to the community in general; and
  - the impact on the corporation.

- the directors must act in good faith and upon reasonable grounds for their belief that substantial damage will result from the take-over.

[197] In Re Olympia & York Enterprises Ltd. and Hiram Walker Resources Ltd. et al.,[140] the court conducted a detailed review of the actions which management of a target corporation may take in the face of a hostile take-over bid. Applying the Teck formulation, the court held that the Hiram Walker directors had acted in the best interests of the corporation and in good faith and, consequently, it was irrelevant that they also benefitted from their actions. Olympia & York adds the following principles to those already advanced by Teck:

- it is the duty of directors in a take-over contest to maximize the value to all shareholders;

- directors are obliged to take steps which they reasonably believe to be in the best interests of the corporation and its shareholders. For example, when directors are faced with an inadequate bid, they must take steps that are in the best interests of the corporation or it will constitute a breach of duty to shareholders;

- directors are entitled to rely on professional advice as to the adequacy of a bid. Evidence of a bona fide reliance will constitute evidence of acting in good faith and upon reasonable grounds; and

- self-entrenchment will not necessarily be inferred where retaining control is secondary to the primary purpose of acting in the best interests of the corporation in good faith.

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[140] (1986), 59 O.R. (2d) 254 (H.C.).

[198] While Olympia & York appears to follow the interpretation of the Teck decision as a new approach to the "proper purpose" rule,[141] this view is not universally accepted. In Howard Smith Ltd. v. Ampol Petroleum Ltd.,[142] the House of Lords expressly refers to the Teck decision as being consistent with the traditional view on defensive measures. The House of Lords goes on to apply the strict "proper purpose" doctrine enunciated in Hogg v. Cramphorn to find a share issuance that affected control *per se* improper.

[199] It has also been suggested that the Teck decision is distinguishable on its particular facts and that the key passages in that case went beyond what was required to arrive at the intended results. In Exco Corporation Ltd. v. Nova Scotia Savings & Loan Co.,[143] which involved a share issuance to a friendly party to block a hostile offer, the court also stated that the Teck ruling was too broad a statement of principle on the facts of that case. After citing a number of Canadian cases "to show that there is no clear line of authority in this country with respect to this area of the law," Richard J. formulates a test in which the directors must show that they acted *bona fide* or without self-interest.

> The test laid out by Berger J. in the Teck case requires further refinement if it is to be applied generally. When exercising their power to issue shares from treasury the directors must be able to show that the considerations upon which the decision to issue was based are consistent only with the best interests of the company and inconsistent with any other interests. This burden ought to be on the directors once a treasury issue has been challenged. I am of the view that such a test is consistent with the fiduciary nature of the director's duty, in fact, it may be just another way of stating that duty.[144]

[200] The Exco decision restricts the Teck principle in that it links the proper exercise of a director's power solely to the best interests of the corporation. To discharge their fiduciary duty, the directors' considerations must be inconsistent with any other interest. The restricted proper purpose doctrine reestablished by Exco affects Teck in a number of ways:

- ! it limits the considerations directors may undertake. Under Teck, directors could consider, for example, the reputation of the offeror, community interests and the interests of employees. Under the Exco test, directors can only act consistently with the best interests of the corporation;

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141 Bruce L. Welling argues that "there is no 'proper purpose' doctrine" applicable to modern Canadian corporate laws (Corporate Law in Canada (:) The Governing Principles, 2d., Toronto, Butterworths, 1991, pp. 336-56).

142 [1974] A.C. 821 (H.C.).

143 (1987), 35 B.L.R. 149 (N.S.S.C.).

144 Ibid., p. 261.

! under Teck and Olympia & York, if the primary purpose is proper, then any secondary benefit to the directors would not invalidate the actions. However, under Exco there would be a breach of duty if directors' actions are consistent with self-interest, i.e. entrenchment. Directors may never be able to meet this burden because a successful defensive measure will preserve the directors' control. Therefore, whenever they maintain control, their actions will not be "inconsistent" with self-interest.[145]

[201] In addition to corporate law fiduciary duties, the Canadian Securities Administrators, in issuing National Policy 38, made it clear that even though they were not prepared to formulate a detailed code of conduct, they were nonetheless interested in developing standards that went beyond those imposed by the fiduciary duties required by corporate law. The philosophical basis given for the policy was the following:

(1) take-over bids have an important role in the economy, for both economic and legal reasons;

(2) target management is in a conflict of interest situation when facing a hostile bid;

(3) the primary objectives of take-over bid legislation is the protection of the *bona fide* interests of target company shareholders;

(4) target company shareholders have the right to make the take-over bid decision;

(5) the appropriate regulatory approach to take-over bids is to encourage unrestricted auctions; and

(6) it is inappropriate to design a specific set of rules regulating target director conduct, other than those imposed by corporate law fiduciary standards.[146]

[202] The first Canadian case in which a court has had to consider a shareholder rights plan is 347883 Alberta Ltd. v. Producers Pipelines Inc..[147] In that case, Producers Pipelines put a

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145 Baxter, M.S., "The Fiduciary Obligations of Directors of a Target Company in Resisting an Unsolicited Takeover Bid", (1988) 20 Ottawa Law Review 88. Professor David Stevens argued in favour of maintaining the traditional English position in Hogg v. Cramphorn, note 136: at the 1995 Meredith Memorial Lectures "Corporations at the Crossroads", May 26-27, 1995, McGill University, Montreal.

146 Beck, S., Wildeboer, R., "National Policy 38 as a Regulator of Defensive Tactics", Meredith Memorial Lectures 1987: Acquisitions and Take-Overs, Cowansville, Qué. Yvon Blais, p. 121.

147 (1991), 80 D.L.R. (4th) 359 (Sask. C.A.).

shareholder rights plan into effect in order to stave off an expected offer from Saskatchewan Oil & Gas Corporation which was acting through its subsidiary 347883 Alberta. Saskatchewan Oil & Gas applied to the courts for an order setting aside the shareholder rights plan on the grounds that it was oppressive and unfairly prejudicial.[148] The plan was never submitted to the shareholders of Producers Pipeline for approval.

[203] The Saskatchewan Court of Appeal granted the application and set aside the plan. The court stated that policy considerations behind securities legislation should influence the court's interpretation of the powers of the directors to act. For example, the court found that the primary role of the directors under securities legislation is to advise the shareholders, rather than decide the issue for them. In particular, the court examined National Policy 38 and held that it must have a substantial impact in any review of defensive tactics against take-overs.[149]

[204] The court further held that directors must exercise their powers in accordance with the duty to act in the best interests of the corporation, even if they find themselves in a conflict of interest. The onus would be on the directors to show that:

- in good faith they perceived a threat to the corporation;
- they acted after proper investigation; and
- the means adopted to oppose the take-over were reasonable in relationship to the threat posed.

Also, any defensive action by the directors would, if possible, have to be put to the shareholders for prior approval or, at a minimum, for subsequent ratification. The court concluded that the directors of the target corporation in the above case did not meet the onus to show that their actions were necessarily in the best interests of the corporation. Of particular importance to the court was the fact that the plan was never submitted to the shareholders. This decision was inspired by the American business judgment rule and United States cases like Unocal Corp. v. Mesa Petroleum Co..[150]

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[148] It was an application under the oppression remedy.

[149] One commentator has criticized the 347883 Alberta Ltd. decision because it suggested that the absence of sufficient guidance in case law concerning directors' fiduciary duties in the course of a take-over bid leaves the court with no alternative but to turn to National Policy 38. The commentator argued that it is unclear why policy statements, which have never been considered by a legislature, issued in a securities law context should become the touchstone for the interpretation of corporate law provisions that are an expression of the will of the legislature. See Yalden, R., "Controlling the Use and Abuse of Poison Pills in Canada: 347883 Alberta Ltd. v. Producers Pipelines Inc.", (1992) 37 McGill L.J. 909.

[150] 493 A.2d 946 (1985).

[205] One important aspect of the Teck case is the position that, when determining what is in the best interests of the corporation, directors are entitled to consider interests other than those of the shareholders.

> . . . If today the directors of a company were to consider the interest of its employees no one would argue that in doing so they were not acting *bona fide* in the interests of the company itself. Similarly, if the directors were to consider the consequences to the community of any policy that the company intended to pursue, and were deflected in their commitment to policy as a result, it could not be said that they had not considered *bona fide* the interests of the shareholders.[151]

[206] This approach is consistent with that applied in the United States.[152] However, it must be noted that, under the principles developed in that country, once it is determined that a company is to be sold, only shareholders concerns are to be considered because the concern is no longer to protect or maintain the corporation, but to sell it to the highest bidder.[153] To this extent, the American position is in accordance with that held by Canadian securities regulators as pronounced in National Policy No. 38 that the target directors must seek out alternative offers or higher bids. However, a commentator[154] has suggested that such an approach should not be followed in Canada. It is argued that no logical alteration of the directors' duties results simply because an "auction" for the company is underway. Interests of constituencies other than shareholders become no less worthy of protection.[155]

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[151] Teck Corporation v. Millar, note 138, at page 314.

[152] Unocal Corp. v. Mesa Petroleum Co., note 150, at page 955: "If a defensive measure is to come within the ambit of the business judgment rule, it must be reasonable in relation to the threat posed. This entails an analysis by the directors of the nature of the takeover bid and its effect on the corporate enterprise. Examples of such concerns may include: inadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on "constituencies" other than shareholders (i.e. creditors, customers, employees, and perhaps even the community generally) . . ."

[153] Revlon, Inc. v. MacAndrews & Fordes Holdings, Inc. 506 A.2d 173 (Del. S.C. 1986), at page 182: "A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders [Unocal]. However, such concern for non-stockholder interests is inappropriate when an auction among active bidders is in progress, and the object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder."

[154] Forsyth, Jody W., "Poison Pills: Developing a Canadian Regulatory and Judicial Response", (1991) 14 Dalhousie Law Journal 191.

[155] The issue of fiduciary duties and non-shareholder constituents is a complex one and beyond the scope of this paper. The Industry Canada Discussion Paper on Directors' Liability, released in November 1995, discusses this issue on pages 19-20. However, neither paper has made an exhaustive review of the substantial volume of case law and legal literature, particularly in the United States, on whose interests directors and

[207] Lastly, one reason for different approaches, or the reason for the historical development of different approaches, may be that different types of corporate laws are involved. The United Kingdom, British Columbia, Nova Scotia have memorandum of association type corporate laws which "often leave the division of powers between shareholders and the board of directors to be determined by the corporate constitution, although some of them have been reformed to set the division of powers in the Act. The unique feature of this model is that the statute invariably contains a section explicitly designating the corporate constitution a contract among the shareholders and between each shareholder and the corporation."[156]

[208] As discussed above, court decisions in Nova Scotia and the United Kingdom (but not British Columbia) have held that the directors' powers must be exercised for a proper purpose. The courts may be concerned that these "contractual" powers of the directors must be carefully circumscribed by a vigorous proper purpose principle.

[209] In contrast to the memorandum of association type of company laws, modern Canadian articles of incorporation type laws[157] grant to the corporation the capacity and powers of a natural person.[158] "[A] division of powers [is imposed] upon the participants -- directors, officers, shareholders, and to a limited extent creditors -- in the internal workings of the corporation. Each category of person, every person attaining the status of director, officer, shareholder or creditor, is assigned by statute certain powers and certain obligations. These statutory powers and obligations will be clarified, sometimes modified, but only rarely removed by the articles of incorporation and subordinate constitutional documents. The corporate constitution is not a contract among participating individuals."[159]

[210] Because it is the statute and not a contract that largely delineates the directors' powers and constrains them (through mechanisms such as shareholder approval for major decisions and the oppression remedy), there may be less concern to narrowly restrict the directors powers by a rigid proper purpose test.

[211] On the other hand, it can be argued that the logic of the proper purpose test is equally applicable (or inapplicable) to the memorandum of association and articles of association types of

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officers may and/or must consider in exercising their fiduciary duties. For example, these issues were discussed in a number of articles published as part of a "Special Issue on the Corporate Stakeholder Debate: The Classical Theory and its Critics" (1993) U.T.L.J. 297-796.

[156] Welling, note 141, p. 55.

[157] Including the CBCA and the Québec (Part 1A), Ontario, Saskatchewan and most other provincial corporate laws.

[158] CBCA, s. 15.

[159] Welling, note 141, p. 54.

corporate laws because the directors' powers, whether statute or contract-based, should be exercised for the purpose for which they are given. Otherwise, directors who exercise their powers for their own benefit breach their fiduciary duty to act in the best interests of the corporation.

[212] The CBCA Discussion Paper on Directors' Liability, released November 1995, also discusses if the fiduciary duties of directors[160] should be redefined in order to clarify the scope of directors' liability.[161] The recommendation made in that Discussion Paper is to the effect that no legislative changes should be made to the current situation and that the courts be left to develop the concept of the "best interests of the corporation."

Recommendation:

[213] It is recommended that no legislative change be made in the definition of the fiduciary duties. The courts should be left to develop the concepts of what is in the best interests of the corporation in hostile take-over bid situations. At the regulatory level, intervention on a case by case basis may arise through securities administrators.

Options:

[214] (A) One option might be to amend the CBCA to provide that the directors be held to have acted honestly and in good faith with a view to the best interests of the corporation under par. 122(1)(a) where the directors discharge the onus of proving that the dominant or primary purpose of their actions was the best interest of the corporation, even though the directors may have directly or indirectly benefited. This option follows the rule set out in Teck Corporation Ltd.

[215] (B) Another option might be to amend the CBCA to adopt, in respect of actions taken by directors in response to a take-over bid, the American business judgment rule. This option follows the rule set out in 347883 Alberta Ltd.

[216] (C) A third option might be to amend the CBCA to expressly provide that the proper purpose doctrine, developed in the context of other corporate regimes, is inapplicable to CBCA corporations. This would leave directors to exercise their powers in accordance with their fiduciary duties.

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160 Generally, not just respecting defensive measures.

161 See Issue 4 in the Directors Liability Discussion Paper (page 14).

B. CODE OF CONDUCT: HOSTILE TAKE-OVER BID

Issue:

[217] Whether directors should be subject to a code of conduct in an hostile take-over bid situation.

Background:

[218] Given conflicting court ruling, it may be important to give directors some guidance in a hostile take-over bid situation. A code of conduct for directors could elaborate the appropriate procedures to follow, such as appropriate approval mechanisms.

[219] In order to avoid a conflict of interest situation, decisions related to defensive measures might be undertaken by a committee of independent directors.[162] It can be argued that an independent director has a much reduced personal interest in the transfer of control. Consequently, the independent director's judgment on the take-over bid are less likely to be influenced by considerations other than what is in the best interests of the corporation.[163] In the Olympia and York decision, Montgomery J. gives considerable weight to an independent director's affidavit which affirms that the sole purpose of the conduct of the directors is to maximize the position of all shareholders.[164]

[220] Shareholder approval might also be a reasonably effective, although not perfect, mechanism for overseeing potential conflict of interest. In many cases shareholder approval may

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[162] Loungnarath, V., "Le droit applicable à l'offre publique d'achat au Québec : une entreprise de synthèse", (1994) 35 Cahiers de Droit 258.

[163] This hypothesis has been criticized by professors MacIntosh and Daniels who mention that corporate interconnectedness and interlocking directorships in Canada have an impact on the efficacy of the oversight exercised by independent directors. (R.J. Daniels, J.G. MacIntosh, "Toward a Distinctive Canadian Corporate Law Regime", [1991] 29 Osgoode Hall L.J. 888-890. However, a code of conduct could attempt to address these considerations through the definition of "independent director."

[164] This position is consistent with a series of decisions where approval of independent directors has been considered as an important factor in the evaluation of the legality of transactions with related persons or in case of going-private transactions (Brant Investment Ltd. v. Keeprite Inc. (1991), 2 O.R. (3d) 289 (C.A. Ont.); General Accident Assurance Co. of Canada v. Lornex Mining Corporation Ltd. (1988), 40 B.L.R. 299 (H.C.); Canadian Gas and Energy Fund Ltd. v. Sceptre Resources Ltd. (1985), 29 B.L.R. 178 (Q.B.); Imperial Trust Co. and Taylor Assets (Dominion) Ltd. v. Canbra Foods Ltd. (1987), 50 Alta L.R. (2d) 275 (Alta. Q.B.); Wesfair Foods Ltd. v. Watt (1990), 73 Alta L.R. (2d) 326 (Q.B.)).

negate a finding of management abuse, although shareholders often can not protect themselves by using the voting process because of the costs of opposing management.[165] It appears that poison pills have been greatly improved as a result of the courts and securities administrators direction that they be approved by shareholders. Corporations now enter into a lot of negotiations with institutional investors in order to gain their support for a proposed poison pill.[166] Most of the new generation of poison pills have moved to requiring renewal every three years from every five years. In addition, new features are added to poison pills regularly. For example, some plans now allow for partial bids.

[221] Any code of conduct may have to distinguish between measures that respond to a particular bid or bids and those that are merely a precautionary measure. Precautionary defensive actions could be subjected to a shareholder approval requirement, but this requirement may be inappropriate to specific defensive tactics, because of timing or cost constraints. An alternative might be to require, for measures responding to a particular bid, review and approval by a committee of independent directors. Shareholder approval, as soon as it is reasonably possible and, in any event, not later than the next special or annual shareholders meeting, could also be required.

[222] If shareholder approval is the key factor, it might be questioned whether defensive measures responding to a particular bid should ever be permitted without shareholder approval. Indeed, shareholders vote with their shares by tendering or not tendering them to the offeror. On the other hand, corporate law fiduciary duties require directors to act in the best interests of the corporation. As Canadian courts have interpreted best interests of the corporation to include more than simply short-term shareholders' value, one might question whether shareholder approval should be the central factor.

[223] It is obviously difficult to strike the right balance among the traditional corporate law objective of giving broad and flexible powers to management, the clear interest of shareholders in exercising their right to agree or refuse to tender their shares and the more general notion of best interests of the corporation.

[224] The way the target corporation gets shareholder approval might also be questionable. Concerns might be raised about whether in some circumstances shareholders have the possibility to vote freely on a defensive measure. In December 1988, Inco Ltd. put for a vote a shareholder rights plan and a special $10 dividend. If shareholders rejected the poison pill, they would not have pocketed the dividend. Some argued that the approval vote was not an endorsement of the

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[165] The cost of preparing a dissident proxy circular to oppose, say, a poison pill, may be prohibitive in relation to the benefits accruing to a shareholder.

[166] McFarland, J., "Poison Pills Sweetened for Shareholders", note 135, page 2.

poison pill but simply a desire of investors to have the $10 dividend.[167] Given the insistence of shareholders and institutional investors, Inco Ltd. offered a new vote four months later. We are not aware of any other case where a defensive measure vote has been linked with another measure.

Recommendation:

[225] In order to regulate the conduct of management in a hostile take-over bid situation, it is recommended that the CBCA be amended so that:

(A) anticipatory defensive measures would be invalid unless approved by a majority of shareholders;

(B) anticipatory defensive measures would be invalid unless reaffirmed by shareholders annually;

(C) defensive measures taken in respect to a particular take-over bid or bids be approved by a committee of independent directors and be approved by shareholders as soon as it is reasonably possible and, in any event, not later than the next special or annual shareholders meeting; and

(D) a shareholders' resolution approving any defensive measures must not be linked with another measure (for example a special dividend).

7. SUMMARY/CONCLUSION

[226] As mentioned previously, the purpose of this paper is to generate discussion on whether the CBCA should continue to regulate take-over bids and, if so, what changes should be made to the current rules. The paper reviewed the history and rationale behind the CBCA's take-over bid provisions. The intent of the CBCA's take-over bid provisions is to protect the interests of shareholders. However, this rationale is counterbalanced by the desire not to unduly impede potential bidders. Take-overs are an important market mechanism through which inefficient management of a corporation can be replaced.

[227] The historical review illustrated that the CBCA's take-over provisions have not been changed since they were first enacted in 1970 and are now out-dated and in need of revision. In

[167] Dingwall, L., "Inco Puts Poison Pill to Shareholder Vote - Again", The Financial Post, March 13, 1989, p. 3.

contrast, the take-over bid provisions contained in the various provincial securities laws have received constant updating and have become largely uniform. This, and the duplicative nature of having both federal and provincial regulation of the same subject-matter, has led many to question the continued need for the CBCA's regulation of take-over bids.

[228] While this paper recommends that the CBCA's take-over bid provisions be retained and up-dated, this is not unconditionally recommended. The recommendation is predicated on the premise that the take-over bid provisions in the CBCA add sufficient value, over and above the provincial securities law requirements, to warrant their retention. One of this paper's most significant recommended departures from current provincial securities law take-over bid requirements, is that the CBCA provide for longer time periods with respect to take-over bids.[168] This recommendation is based on the belief that the current minimum time periods for take-over bids are too short.

[229] In fact, all the recommendations contained in this paper are not in any sense the final word on changes to the CBCA's take-over bid provisions. They represent current thinking but are not government or even departmental policy. This paper, and the consultations that will follow, are intended to solicit from the public ideas on how the CBCA's regulation of take-over bids can be improved.

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[168] See Issue 5(J).