Les Cahiers de droit

# The Sale of control and the Ontario follow-up offer

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Volume 23, numéro 1, 1982

URI : https://id.erudit.org/iderudit/042491ar
DOI : https://doi.org/10.7202/042491ar

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Éditeur(s)

Faculté de droit de l'Université Laval

ISSN

0007-974X (imprimé)
1918-8218 (numérique)

Découvrir la revue

Citer cet article

Leclerc, G. (1982). The Sale of control and the Ontario follow-up offer. *Les Cahiers de droit*, *23*(1), 35–133. https://doi.org/10.7202/042491ar

Résumé de l'article

Cet essai se veut une analyse exhaustive de l'une des dispositions les plus controversées de la loi sur les valeurs mobilières d'Ontario, soit l'offre équivalente (follow-up offer). L'article 91(1) du *Securities Act, 1978* stipule que lorsque les valeurs d'une compagnie conférant à l'acheteur le contrôle effectif sur celle-ci sont acquises de moins de 15 détenteurs à un prix supérieur de 15% du prix du marché, l'acquéreur doit offrir aux actionnaires minoritaires d'acheter leurs valeurs pour une considération au moins équivalente à celle payée antérieurement. Cette disposition vise à réglementer la vente des valeurs conférant le contrôle où une prime excessive était payée à leur détenteur sans que les autres actionnaires puissent la partager.

Après avoir rappelé l'évolution de la législation relative aux prises de contrôle, l'auteur situe les axes fondamentaux sous-tendant l'offre équivalente, soit l'égalité de traitement et la crédibilité du marché des valeurs.

L'étude détaillée du fonctionnement de l'offre équivalente est ensuite abordée ; l'auteur s'efforce de mettre en parallèle l'évolution de la situation du marché en Amérique du Nord ainsi que l'interprétation de l'offre équivalente, la première expliquant la seconde. Les principes d'égalité de traitement et d'équilibre entre les différentes parties lors de prises de contrôle sont mis en évidence pour justifier certaines décisions.

L'auteur conclut en s'interrogeant sur la justesse des principes actuels qui guident l'actuelle législation. La judiciarisation excessive de tout ce domaine porte à croire qu'une révision des modes actuels d'intervention de la Commission ontarienne devrait être entreprise.

# The Sale of control and the Ontario follow-up offer *

Gilles Leclerc **

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* This is a completely revised and updated version of a paper originally completed in August of 1981 and submitted to the Faculty of Law of the University of Toronto for a Master in Laws. The research is up-to-date to January 19, 1982 in respect of journals and to April 1, 1982 in respect of statutes, caselaw and other relevant material. On June 21, 1982, the Quebec Government tabled Bill 85 titled *Securities Act*. This Bill, which was received by the author after this article had been sent to the printer, does not contain a section similar to s. 91(1), but limits the private agreement exemption, which will be an exempted takeover bid, if the securities are acquired at a cost not higher than 15% above the average market price. See s. 116(3).

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**_Les Cahiers de Droit_, vol. 23, nº 1, mars 1982, pp. 35-133**
**(1982) _C. de D._ 35**

## 1. Introduction

> "Of course its unethical,
> its business."
>
> Ben WICKS, *The Globe and Mail, April 8, 1982, B-1*

1. On June 23, 1978, Bill 7 was given assent by the Ontario Legislative Assembly and was proclaimed in force a year later, in September 1979[1]. In this *Act* one finds the actual mechanism of the private agreement followed by what is known as the follow-up offer. Generally speaking, where a purchaser acquires a holding of more than 20% of voting securities through one or several private agreements at a consideration of 15% above the market price, the purchaser has to make an equivalent offer to the remaining security holders within 180 days of the agreement. The combined effect of s. 88(2)(c) and 91(1) is to prohibit a controlling shareholder from selling his control block at an excessive premium without the same opportunity being given to minority shareholders.

Because a certain amount of premium is allowed, the actual mechanism may be seen as a compromise between the two opinions expressed in 1973 by the Select Committee on Company Law[2], a compromise which has not always been included in the various drafts of the new securities act. In Bills 154 and 75, tabled in 1972 and 1974 respectively, the private agreement exemption was retained. It was later dropped in Bills 98, 20 and 30, the latter two having been proposed in 1977 and finally reintroduced in Bill 7 in 1978, where the follow-up was then included.

2. The policy considerations underlying the introduction of the follow-up offer in Ontario may be classified into two categories. The first is framed on an attempt to promote confidence in the marketplace[3]. The Commission expressed concerns following an increase in the frequency of sales of control whereby controlling shareholders were allowed a premium with no general offer being made to all shareholders[4]. Together with a statement made by

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1. S.O. 1978 c. 47, now R.S.O. 1980 c. 466 [hereinafter referred to as *1978 Act* or the *Act*].
2. See *infra*, #21 and ff.
3. See *e.g. In the Matter of Stuart Bruce McLaughlin, and S.B. McLaughlin Associates Ltd*, (1981) 1 *O.S.C.B.* 98C, p. 111C (June 5); (1981) 14 B.L.R. 46, p. 54; appeal to Divisional Court dismissed, (1981) 2 *O.S.C.B.* 385C (Nov. 6), and appeal to the Court of Appeal dismissed (1981) 2 *O.S.C.B.* 408C [hereinafter referred to as *McLaughlin*].
4. In informal announcements, the OSC expressed the view that "as a matter of fairness or ethics, such a purchaser should make an offer of equivalent value to the minority shareholders". See V.P. ALBOINI, *Ontario Securities Law*. Toronto, Richard DeBoo, 1980, p. 684 [hereinafter referred to as *Alboini*].

the Minister[5] responsible for the *Act*, they are indicative of the importance attached to the credibility of the marketplace as well as to the protection of the public, being in this case the minority shareholders. The same type of argument was put forward in 1965 to explain the legislation dealing with takeover bids and insider trading[6]. At that time, it was concluded that the argument was inapplicable to this particular situation. Several years later, the beliefs that the public, the minority shareholders, was not in jeopardy where a sale of control by private agreement was concluded and that the common law was a sufficient remedy were abandonned and legislative protection enacted[7]. Indeed, the hope that the judicial process would develop remedies to deal with these situations has proven ineffective[8]. The frequency of such transactions was likely a major factor in the adoption of the follow-up offer. In fact, few sales of control by private agreement took place when the Kimber Committee released its Report.

3. The follow-up offer indicates that the effectiveness and the credibility of the marketplace, where control of a corporation is sold by private agreement, can be achieved through an equality of treatment among shareholders[9]. Using the introductory language of the *City Code*[10], both the

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5. Two statements were made. The first one occurred late in February 1978, and justified the reinstatement of the private exemption and its restriction by the follow-up requirement by using some administrative reasons. See (1978) *Legislature of Ontario Debates Official Report (Hansard)* 165, p. 166; it was also reproduced in (1978) *OSC Weekly Summary*, March 3, Notice I, 2a, p. 3a.
A second statement was made four months later, such statement being the most relevant. It reads as follows:

> "After careful consideration, we have concluded that it is prejudicial to the credibility of the public marketplace to permit the owner of a corporation who has taken in minority shareholders to dispose of his shares subsequently at a premium that is unavailable to the minority. The provisions in Bill 7 are designed to prevent this abuse but to retain maximum flexibility in order not to impose any unnecessary restraint on dealings in control blocks. Accordingly, no change is proposed at this time in these provisions of the Bill."

See (1978) *OSC Weekly Summary*, August 11, p. 4.

6. See *infra*, #11 to 19.
7. See *e.g. Chairman Report*, (1982) 3 *O.S.C.B.* 79A, p. 82A (Feb. 26).
8. See *In the Matter of Torstar Corporation, and Harlequin Enterprises Ltd*, (1981) 1 *O.S.C.B.* 62C, p. 67C [hereinafter referred to as *Torstar*]; *McLaughlin, supra*, note 3, p. 110C; p. 58.
9. See *Torstar, supra*, note 8, p. 68C; *McLoughlin, supra*, note 3, pp. 109C and 114C; p. 57 and 61-62; see *infra*, #65 and ff.
10. *The City Code on Take-Overs and Mergers* [hereinafter referred to as *City Code*] was first issued in March 1968 by the City Working Party, and is considered a development of the *Notes on Amalgamations of British Businesses* issued in 1959. The Code provides a voluntary self-discipline system supervised by a Panel. For an excellent description of its functioning, see M.A. WEINBERG, M.V. BLANK, A.L. GREYSTOKE, *Weinberg and Blank on Take-Overs and Mergers*, (4th ed.) London, Sweet & Maxwell, 1979, ch. 12 [hereinafter referred to as *Weinberg and Blank*].

Select Committee and the OSC acknowledged that a follow-up offer was a "good, standard commercial behaviour based upon a concept of equity between one shareholder and another"[11]. Although there was no compulsory offer to the remaining shareholders before 1978, several cases were observed in Ontario where such an offer was made by the controlling shareholder following a sale of control[12]. Indeed, the Commission said in February 1979 that it

> [...] has been accepted as good commercial practice to require the offeror to make a similar although not always identical offer to all shareholders where control was secured through private agreement.[13]

4. A similar concern for minority shareholders upon the conclusion of private agreements was expressed in the United States. A thesis submitted by one commentator also advocated an equality of treatment between majority and minority shareholders. In 1965, Professor Andrews put forward the following idea called the equal opportunity rule:

> [t]he rule to be considered can be stated thus: whenever a controlling stockholder sells his shares, every other holder of shares (of the same class) is entitled to have an equal opportunity to sell his shares, or a prorata part of them, on substantially the same terms. Or in terms of the correlative duty: before a controlling stockholder may sell his shares to an outsider he must assure his fellow stockholders an equal opportunity to sell their shares, or as high a proportion of theirs as he ultimately sells of his own.[14]

5. The follow-up offer is also based upon another American theory proposed in the early thirties, whereby control is viewed as being a valuable asset in itself. This theory has been clearly stated by the Commission in its decision in *BCFP-Noranda-AEC(1)*, where it said that

> [...] it is important that one goes to the underlying principles. Ontario mandates that premiums paid for "control" are to be shared among all security holders of the class of securities being acquired. Such principles include the concept of a vendor knowingly and willingly disposing of an asset that includes the means to control, that is the vendor has the intention of disposing not only of the securities owned but of the means of control associated with those securities at a premium above the "market price".[15]

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11. See *Policy 3-41, infra*, note 345, p. 173.
12. See *infra*, # 19 and note 70.
13. See *Draft Policy, infra*, note 344, p. 8.
14. W.A. ANDREWS, "The Stockholders' Right to Equal Opportunity in the Sale of Shares", 78 *Harv. L. Rev.* 505, p. 515 (1964-65), *see infra*, #27 and ff.
15. *In the Matter of British Columbia Forest Products Ltd. Noranda Mines Ltd, and Alberta Energy Company Ltd*, (1981) 1 *O.S.C.B.* 116C, p. 118C (June 19) [on 99b; hereinafter referred to as *BCFP-Noranda-AEC(1)*]; see *infra*, # 40 and ff.

6. This point of view, based upon the underlying premises and the historical evolution of the takeover bid legislation in Ontario, has recently been questionned by a group of securities practitioners in an *Interim Report* released late in November 1981[16]. For them,

> the receipt of a premium by the vendor is no longer the basis of a perceived abuse (as under the corporate asset and breach of fiduciary duty theories) but is instead the trigger for this new right conferred on minority shareholders.[17]

They have consequently suggested that in the future the follow-up offer requirement be triggered by an acquisition of effective control rather than by an infringment of the so-called minority shareholders' rights in the takeover contexts. They went on to say that the actual mechanism set up in s. 91(1) was inappropriate to achieve its objective (*i.e.* the distribution of the premium obtained from the sale of a controlling interest) and stressed the deterrent and excessive effect of such an obligation upon the Canadian capital market[18].

The authors of the *Interim Report* correctly pointed out that more rights were conferred to minority shareholders where takeover bids are implemented. It must however be stressed that such a principle clearly underlies the actual legislation on takeover bids, and that s. 88(2)(c) and 91(1) are an integral part thereof. Taking into consideration the reasons behind the introduction of the takeover bid regulation in 1965[19], it is submitted that the follow-up offer may be viewed as a "logical" step forward; whether this step was appropriate or whether it was necessary and useful are rather different questions[20].

It should however be noted that Ontario is the only Canadian jurisdiction where such pattern of legislation is operative. The federal government criticized it on two occasions, once through the report of the Royal Commission on Corporate Concentration[21] and more recently in its Proposals for a Canadian securities act[22], in which the same pattern was not

16. *Interim Report of the Committee to Review the Provisions of the Act Regulating Take-Over Bids.* (1981) 2 *O.S.C.B.* 212A (Nov. 27) [hereinafter referred to as the *Interim Report*].
17. *Id.*, p. 229A.
18. *Id.*, pp. 230-31A.
19. See *infra*, #9 and ff.
20. See *infra*, note 90.
21. *Report of the Royal Commission on Corporate Concentration.* Ottawa, Minister of Supply and Services, March 1978, pp. 138-39.
22. *Proposals for a Securities Market Law for Canada.* Ottawa, Minister of Supply and Services, 1979, vol. 2, #7.19, pp. 123-24 [hereinafter referred to as *Proposals*, followed by the appropriate volume number (there are three of them)].

included. The Province of Québec, when releasing its own proposals for a new legislation[23], also decided against following the policy choice made by Ontario, similarily as Alberta did in its new *Securities Act, 1981*[24]. Only Manitoba, through a new *Securities Act*, has followed Ontario; this legislation has however not yet been proclaimed[25].

7. It is interesting to note that similar developments took place in Europe in the seventies. Generally speaking sales of control effected through private purchases with no general offer have raised public criticism somewhat similar to those made here. For instance, the *Commission Bancaire belge* released in its 1978-79 annual report a consolidation of its decisions and recommendations issued during the preceding ten years. They are based upon the following premises: the necessity to assure participants that the marketplace is efficient and fair to them; the equality of every shareholder and the sharing by everyone of the premium paid in a sale of control. The *Commission* has suggested that the principle of equality of treatment would be best respected if a public offer at a similar consideration was made to all shareholders where control is sold privately.

The European Commission issued in 1977 a Code of Conduct[26] related to transactions in transferable securities. This Code, issued as a Commission recommendation, stresses that equality of treatment should be guaranteed to all holders of the same class of securities. This equality, together with an equal opportunity given to remaining shareholders, should be found where control is sold, either privately or by way of a public offer. These examples demonstrate that the sale of control problems are not limited to Ontario, but are rather common to countries where capital markets are an essential part of the economy.

8. The aim of this essay is to review and analyse the follow-up offer as known and applied in Ontario. Chapter 2 will be devoted to a brief review of the evolution of the takeover bid rules, while Chapter 3 will analyse the manner in which s. 88(2)(c) and 91(1) are brough into play. A study of the discretionary powers conferred to the OSC with respect to the follow-up offer will be found in Chapter 4.

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23. Commission des valeurs mobilières du Québec. *Réforme de la loi sur les valeurs mobilières. Document de consultation*, (1980) [hereinafter referred to as *Quebec Working Paper*]; but see Bill 85, s. 116.
24. S.A. 1981, c. S-6.1.
25. *The Securities Act, 1980*, S.M. 1980, c. 50.
26. *Commission Recommendation, July 25, 1977, concerning a European Code of Conduct Relating to Transactions in Transferable Securities*, (1977) *O.J.E.C.* L 212-37. 77/534/EE5.

## 2. The origin of the follow-up offer

### 2.1. The basic principles of takeover bid rules their evolution: from 1965 to 1973

#### 2.1.1. Principles underlying the takeover bid

9. The private agreement was originally an exemption from the application of the takeover bid rules to the offeror. In other words, the offeror did not make a takeover bid while concluding an agreement with less than fifteen security holders for the acquisition of their voting securities.

10. Introduced in 1966, the section of *The Securities Act, 1966* [27] dealing with takeover bids was one of the innovations recommended [28] by the *Kimber Report* [29]. At the time it was tabled, there was no existing legal framework in the U.S. governing takeover bids [30], though there were provisions in the U.K. While the Committee considered the English system, it emphasized that its recommendations would be guided by domestic factors first rather than by a foreign experience [31]. The Report then stressed that the primary objective of the takeover bid legislation should be to provide the offeree shareholder with sufficient protection of his *bona fide* interests. This could be achieved through an accurate disclosure of information, both

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27. S.O. 1966 c. 142, s. 80(g), Part IX, which became *The Securities Act*, RSO 1970 c. 426, s. 81(g) and s. 81(b) for the private agreement [hereinafter referred to as *1966 Act*, but with the RSO 1970 numbers].
28. See *infra*, # 14 and ff.
29. Province of Ontario: *Report of the Attorney General's Committee on Securities Legislation in Ontario*, (1965) [hereinafter referred to as the *Kimber Report*].
30. Legislation in the U.S. with respect to takeover bid was introduced in 1968 through *The Williams Act*, 15 U.S.C. § 78 m(d)-(e) and § 78 m(d)-(f); it constituted an amendment to the *Securities Exchange Act of 1934*, 15 U.S.C. § 78a-78jj. See E.R. ARANOW, H.A. EINHORN, *Tender Offers for Corporate Control*. New York, Columbia University Press, 1973, pp. 69–77 and the Supplement thereof published in 1977, pp. 1–10. There is no follow-up offer in the U.S. at the present time, and none is intended to be implemented. See *ALI Fed. Sec. Code*, (1980), § 202 (166)(A).
    It seems however that the scope of application of sales of control at a premium will be seriously narrowed. The tender offer requirements will apply where an acquisition of equity securities by a purchaser provides him with an ownership of more than 5% in the class of equity sought. *ALI Fed. Sec. Code* § 606(A). With the disclosure required, [§ 605,06,07] and the individuality of each tender offer [§ 202(166)(B)], it is likely that transactions in which a large premium, unavailable to minority shareholders, was paid will be more difficult to conclude and indeed, should be less frequent.
31. *Kimber Report*, *supra*, note 29, # 3.03.

procedurally and in substance [32], designed to permit offeree shareholders to reach "[...] a reasoned decision as to the desirability of accepting a bid for their shares" [33]. The Report also attempted to ensure a certain from of equality of treatment among shareholders [34], especially in respect of the price offered and on the *pro rata* acceptance of shares tendered in a partial takeover bid. However, the Committee made it clear that its recommendations

> [...] would not unduly impede potential bidders or put them in a commercially disadvantageous position vis-à-vis en entrenched and possible hostile board of directors of an offeree company.[35]

11. Other concerns of the Kimber Committee were the lack of public confidence in the securities industry, and various public criticisms of many aspects of the securities regulation in Ontario. These points were discussed in relation to the efficiency of the secondary market [36] and were also referred to where insider regulation was approached [37], the Committee believing it was "[...] improper for an insider to use confidential information acquired by him by virtue of his position as an insider to make profits by trading in the securities of his company" [38]. The behavior of insiders in takeover situations was also considered by the Kimber Committee. Referring to the press criticisms [39], it called such behavior "[p]erhaps the most controversial

32. *Id.*, #3.10; see also P. ANISMAN, *Takeover Bid Legislation in Canada: A Comparative Analysis*. Toronto, C.C.H. 1974, pp. 16–18 [hereinafter referred to as *Anisman*]; D.L. JOHNSTON, *Canadian Securities Regulation*. Toronto, Butterworth, 1977, p. 319 [hereinafter referred to as *Johnston*]. Anisman has exposed specific criticisms over the sole disclosure requirements as being an insufficient means *per se* to adequately protect the offeree shareolder. He has also noted that the method of acquisition would require to be regulated. This item was indeed considered by the Kimber Committee when it discussed the behavior of insiders during takeover bids. See *infra*, #16.
33. *Kimber Report*, *supra*, note 29, #3.10; see also *In the Matter of the take-over bid by Federal Commerce & Navigation Ltd and in the Matter of the take-over bid by Olympia & York Investments Ltd*, (1981) 1 *O.S.C.B.* 20C, p. 25C (April 24).
34. *Kimber Report*, *supra*, note 29, #3.17; see *Johnston*, *supra*, note 32, p. 319; *Anisman*, *supra*, note 32, p. 18. However, both made different comments on the same issue. Anisman has written a footnote speaking about the accepting shareholders while Johnston has discussed partial bids.
35. *Kimber Report*, *supra*, note 29, #3.10. See also *Johnston*, *supra*, note 32, pp. 319-20.
36. *Kimber Report*, *supra*, note 29, #1.11 and #1.12.
37. *Id.*, #2.02 and 2.32; see J.C. BAILLIE, "The Protection of the Investor in Ontario", (1965) 8 *Can. Pub. Admin.* 172, pp. 254–58 for a review of the considerations underlying the Kimber recommendations in respect of insider tradings.
38. *Kimber Report*, *supra*, note 29, #2.02; see also H.P. CRAWFORD, "Insider Trading", (1965) 8 *Can. B.J.* 400.
39. *Kimber Report*, *supra*, note 29, #3.08; see also J.P. WILLIAMSON, *Supplement to Securities Regulation in Canada*. Toronto, University of Toronto Press, 1966, pp. 383 and ff.

feature of take-over bid transactions". The same situation was observed in the chapter of the *Kimber Report* dealing with takeover bids. The Report made clear reference to the pressure exercised by the general public in the preceding years[40] by stating that there had been

> [...] criticism by the general public, the financial community and the press concerning both the form and effect of numerous commercial transactions whereby a company or a bidding group has sought to acquire legal or effective control of another company by a procedure which has come to be known as a 'take-over bid'.[41]

12. In fact, the Report and its recommendations are based on the premise that the improvement of securities legislation in favour of investors will benefit the industry; in return, the general public will take advantage of a more effective and more efficient securities industry[42], each contributing to the other[43]. The concept of disclosure of information required from public companies, insiders and offerors in takeover bid situations, as well as the civil liability of insiders when dealing with their corporation's stock, were therefore introduced in the *1966 Act* following recommendations of the *Kimber Report*. They were considered as being "major steps forward"[44] in the area of investor information, viewed by the Committee as a factor of public confidence[45] and protection, as well as the thrust toward even handed dealings[46].

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40. See *Johnston, supra*, note 32, pp. 15 and 318, noted that one of the reasons for the creation of the Kimber Committee was the widespread allegations about the use of inside information in a takeover bid by Shell Oil Ltd for Canadian Oil Ltd. See also J.C. BAILLIE, *supra*, note 37, pp. 207–10 and pp. 258–63 for a review of the events which took place between 1963 and 1965.

41. *Kimber Report, supra*, note 29, #3.01. It has to be noted that similar reasons were at the origin of much of the actual legislation regulating takeover bids in the United States and in Europe. See *e.g.* for the U.S. E.R. ARANOW, H.A. EINHORN, *supra*, note 30. For Europe see *e.g.* R. WTTERWULGHE, *L'offre publique d'acquisition au service d'un marché des sociétés*, Bruxelles, La Renaissance du livre, 1973; see also M.F. COHEN, "A Note on Takeover Bids and Corporate Purchases of Stock", 22 *Bus. Law* 149 (1966-67).
This situation is far from being closed. In August 1980, the Campeau Corporation attempted to takeover Royal Trustco Corporation. The bid was finally unsuccessful, but raised one of the most serious and bitter battles ever seen in Canada. The price offered by Campeau was substantially above the market price of the shares. The press throughout the country made critical comments about the underlying motivations for the management's opposition to the bid *versus* the interests of the shareholders. See *e.g. The Globe and Mail*, editorial note "As giants do battle (1) and (2)", October 21 and 22, 1980: "But how well were the ordinary shareholders of Trustco served, ... how protected are ordinary shareholders among such giants?". See also A. BOOTH, "OSC hearing a venture into unknown territory", *The Financial Post*, Jan. 24, 1981, p. 4.

42. *Kimber Report, supra*, note 29, #1.17.

43. P. ANISMAN, P.W. HOGG, *infra*, note 166, p. 138.

44. *McLaughlin, supra*, note 3, p. 110C; p. 58.

45. *Kimber Report, supra*, note 29, #1.17; see also #2.02, #2.04 and #3.10.

46. *McLaughlin, supra*, note 3, p. 110C; p. 58.

13. The *Merger Study*[47], released in February 1970, did not add much to the background on which the takeover provisions rely, but underlined some of the drawbacks of such transactions [48] for the minority shareholders.

### 2.1.2. Principles underlying the private agreement

14. Immediately following the paragraph where the Kimber Committee laid its views on how a takeover bid should be defined, it explained why transactions of blocks of shares, representing legal or effective control and acquired by way of private agreement [49], were eliminated from the definition. Even though the Committee recognized that the general body of shareholders would be refused the same opportunity to tender its shares and deprived of the premium offer received by the controlling shareholders when control was sold by private agreement, it stated

> [...] that the evolution of a legal doctrine which may impose upon directors or other insiders of a company who constitute a control group a fiduciary duty toward other shareholders of such company in cases of change of control is, apart from insider trading aspects, a matter to be left to development by the judicial process.[50]

15. Several inferences may be drawn from this conclusion. Firstly, the Committee implicitly admitted that nothing in the actual state of law in Ontario was designed to deal with the sale of control by private agreement. The common law, using the concept of fiduciary duties, was at that time underdeveloped and inadequate in covering these transactions [51]. It is however unclear what the Committee's intentions were with regard to this recommendation. It was suggested [52] that it had anticipated the evolution of the legal doctrine in Canada following that of the U.S., where directors and controlling shareholders have sometimes been held to be subject to fiduciary duties when selling a control block [53]. In respect of this argument, it was unclear whether the Canadian courts would adopt the U.S. position [54], the

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47. Department of Financial and Commercial Affairs : *Report of the Committee of the Ontario Securities Commission on the Problems of Disclosure Raised for Investors by Business Combinations and Private Placements* (1970) [hereinafter referred to as the *Merger Study*].
48. *Id.*, pp. 88-89. See *infra*, #19.
49. See *Anisman, supra*, note 32, pp. 37 and ff.
50. *Kimber Report, supra*, note 29, #3.12.
51. See *infra*, #28, #29, #67 and #146; see also *Pelling et al. v. Peeling et al.*, (1982) 130 D.L.R. (3d) 761, p. 762.
52. *Torstar, supra*, note 8, p. 67C.
53. *Infra*, #30 and 31.
54. F. IACOBUCCI, "Canadian Corporation Law: Some Recent Developments", lecture delivered at Cambridge University, July 28, 1981, for the benefit of the Canadian Institute for Advanced Legal Studies, p. 21.

Committee itself expressing its doubts by the expression "legal doctrine which may impose upon [those] who constitute a control group a fiduciary duty toward other shareholders" [55].

It was also suggested that the Kimber Committee was reluctant "[...] to move further than necessary in the absence of further facts" [56]. Indeed, transactions whereby control was sold at a premium were unusual in Canada, although somewhat frequent in the U.S.[57] It is also undetermined whether the Committee preferred to rely on the inherent flexibility of the common law, whether this decision to exclude private agreements from the takeover definition was wise [58], optimistic [59], or simply whether the Committee avoided facing the problem.

16. A second observation comes from the last part of the statement and is rooted in the exemption allowed for insider trading. The Committee agreed to regulate such aspects of the sale of control even though not regulating the whole system. What is interesting in this case is that Canadian common law was again clearly inadequate and weak in its efforts to protect shareholders, that is to regulate misuse of confidential information and profits arising thereby [60]. These weaknesses led the Kimber Committee to recommend a "two-fold remedy" which substantially altered the state of law as it stood in 1965: full and public disclosure of all transactions effected by insiders and, the disclosure being insufficient in itself, an "[...] effective procedure to recover any benefits derived by those who engage in improper insider trading" [61]. The proposed legislation in respect of insider tradings was linked to the public confidence aspect of the Report, as well as to the objective of protecting the public. In the case of insider trading, public confidence in the market was in jeopardy. The same issue was behind the takeover legislation, but in this context, "public" meant only the offeree shareholders. In both cases, the public had to be protected. In both cases, such protection was given by disclosure requirements, specific timing provisions, equality of treatment and new weapons to be used in the courts. These recommendations were designed to secure, improve and restore public confidence in the securities industry. For the reasons discussed above, this moral concern was nonexistent with respect to private agreements. Combined with the Committee's unwillingness to set up a comprehensive

55. *Kimber Report, supra*, note 29, #3.12.
56. *McLaughlin, supra*, note 3, p. 110C; p. 58.
57. See *infra*, #30 and ff.
58. J.C. Baillie, *supra*, note 37, p. 259.
59. D.D. Prentice, "Takeover Bids: Part IX of the Ontario Securities Act 1966", 19 *Am. J. Comp. Law*, 325, p. 341 (1971).
60. *Kimber Report, supra*, note 29, #2.03.
61. *Id.*, #2.04.

regulation of the securities industry, or to produce a national securities code, it was not felt necessary to regulate such sales of control: therefore "private agreements" were excluded from the takeover definition.

17. Another reason behind the existence of the private agreement exemption is that buyers and sellers did not need the kind of protection afforded by the *Act*[62]. In fact, the legislation focused on the principals in the transaction instead of the remaining shareholders. Given the large amounts of money as well as the number of shares involved, the *Act* assumed that the participants were sophisticated enough to know what they were doing and did not need the protection of the statute[63]. In addition, the equality of bargaining power[64] between buyers and sellers and the access to relevant information also made the legislation unnecessary[65].

18. But in a different way, it was not the aim of the *Act* to attempt to regulate transactions where the public was not involved[66], such as those involving private companies as well as many other exemptions. The private agreement exemption, seen in the context of an offer not made to the shareholders generally[67], might well be included in this category of private transactions. It was then enacted in a logical manner, even though it was unable to adequately protect those shareholders not directly involved in such transactions.

19. The *Merger Study* released in 1970 did not propose any major modification of the statements made by the Kimber Committee. The opinion of the *Study* as to the oppression of the minority[68] is unclear and has been criticized by Anisman as drawing an artificial distinction between corporate and securities law[69].

The private agreement exemption was seen in the *Merger Study* as raising questions about the premium over the market price paid on a sale of

62. This proposition implies that no premium is paid. See *infra*, #25.
63. See *Johnston, supra*, note 32, p. 330; N.N. ANTAKI, G. LECLERC, "Le droit des valeurs mobilières et les placements privés", (1979) 20 *C. de D.* 725.
64. N.N. ANTAKI, G. LECLERC, *supra*, note 63, #43 and 44.
65. *Anisman, supra*, note 32, p. 41.
66. This is the case in the U.S., where authors have said that the concept of tender offer excluded private purchases of shares, the term "private" having a similar connotation to the one used in s. 4(2) of the *Securities Act of 1933*, 15 U.S.C. § 77a-77aa.
See E.R. ARANOW, H.A. EINHORN, *supra*, note 30, pp. 70–73 and pp. 2–4 of their Supplement.
67. See for discussion *Anisman, supra*, note 32, pp. 41–44; D.D. PRENTICE, *supra*, note 59, pp. 332–34, who has suggested similarities with public offerings; *Johnston, supra*, note 32, pp. 324-25 and p. 330.
68. *Merger Study, supra*, note 47, #7.03; see *supra*, #13.
69. *Anisman, supra*, note 32, p. 16 and footnote 25.

control. Even though the *Merger Study* looked at the *City Code* and even though it observed a certain concern for the minority shareholders in a number of cases [70], it found that the controlling stockholders had not "[...] so abused their positions as to require special treatment as a matter of securities legislation" [71]. In accordance with the evidence, it concluded that there was no reason to deviate from the *Kimber Report* "[...] as to questions of fairness of treatment as between shareholders [72]", such a matter being properly left to the corporate law and the courts. It did suggest, however, that the number of shareholders involved in a private agreement be limited to fifteen [73].

### 2.2. The evolution of the basic principles and the birth of the follow-up offer: from 1973 to 1978

#### 2.2.1. The Select Committee on Company Law

20. In 1973, the Select Committee on Company Law tabled its report on mergers, amalgamations and certain related matters [74]. In chapters 10 to 17, the Committee dealt with almost all the various aspects of takeover bids. In the eleventh chapter, the private agreement was considered, a subject which deeply divided the Committee into two factions [75].

21. The problem was approached similarly as it had been in 1965 and 1970. The Select Committee acknowledged that a premium was almost invariably paid to the controlling shareholders and in many cases, no general offer involving the same terms was made to the other shareholders [76]. The Select Committee then stated three different options facing it:

> [s]hould this situation be allowed to continue, should the legislation remove the present private agreement exemption or should the legislation continue the

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70. Four cases of offers made to the remaining shareholders out of a total of 87 bids collected. Other cases were mentioned, but without specific numbers.

71. *Merger Study, supra*, note 47, #7.09; see also #7.04. Before this statement, they explained the economic drawbacks of an offer to every shareholder as removing incentives for entrepreneurship.

72. *Ibid.*; see also D.D. PRENTICE, *supra*, note 59, pp. 342-43, for comments on the recommendations of the *Merger Study*; see also *Torstar, supra*, note 8, pp. 67C-68C.

73. *Merger Study, supra*, note 47, #7.10. This recommendation was put into legislation in 1971 through s. 22 of *An Act to amend The Securities Act, 1966*, S.O. 1971 c. 31.

74. Select Committee on Company Law, *1973 Report on Mergers, Amalgamations and Certain Related Matters by Select Committee on Company Law*, (1973), Ontario Legislative Assembly, 3rd Session, 29th Legislature, 22 Eliz. II [hereinafter referred to as *Select Committee Report*].

75. *Id.*, ch. 11, #6.

76. *Id.*, ch. 11, #1.

> exemption but require, as a condition, that a general offer be made by the offeror to all other shareholders of the same class?[77]

After having consulted the *Merger Study*, the *City Code* and the new opinion released by the OSC, each faction put forth its views.

22. The majority favoured the exemption as it existed in the *1966 Act* without having to make any general offer to the remaining shareholders. This, together with the idea of abolishing the exemption, to which the majority disagreed, was seen as discouraging the entrepreneurship of businessmen[78]. It further pointed out that shares were the personal property of their owner who should be left free to dispose of them at whatever terms he considered advisable. It also expressed the view that the behavior of controlling shareholder in relation to the corporation's affairs was not the focal point "[...] but his freedom to dispose of his shares privately as he thinks fit and that his freedom should not be diminished unless there are cogent overriding reasons for doing so"[79].

These arguments were then followed by a second type based upon a so-called economic rationale. The majority said that a prospective purchaser, although having sufficient resources to buy the controlling interest, might not be able to extend his offer to the general body of shareholders. Having qualified a general offer as an economic hardship, it further stated that the result of such an offer would be that only those who could afford it would consider a purchase of control.

Finally, the majority put forward a third type of argument which was rooted in a legal basis. They rejected the principles laid down in the *City Code* saying that

> [...] such principles do not represent a legal enactment but are of persuasive force only and that in any event such principles have been developed for application to a financial system whose resources, philosophy and operations are different from our own.[80]

23. The minority views expressed in the *Select Committee Report* are generally seen as the origin of the follow-up offer presently known in Ontario. At the very beginning of its opinion, it formulated its views in this way:

> [t]he minority of the Committee [...] is of the view that, while the sale of control or effective control by private agreement should not be abolished, the present

77. *Ibid.*; see also ch. 11, #3.
78. *Id.*, ch. 11, #7.
79. *Ibid.*
80. *Ibid.*

> exemption in The Securities Act should be made conditional on the person acquiring such control making within a reasonable period (which the minority feels should be not later than 60 days after acquisition of control) an offer to the remaining shareholders of the same class which offer should not be conditional on any level of acceptance. Such a requirement should also cover a change of control or effective control by private agreement in the case of a private company.[81]

24. Firstly, the minority agreed with the majority that the reduction if not the elimination of the premium on a sale of control might be viewed "[...] as a move towards removing an incentive for entrepreneurship"[82]. However, it expressed doubts as to the forcefulness of the argument permitting such a premium. Secondly, and this being a major difference from the majority opinion, it stated that each share of the capital was, at least conceptually, the same as every other share and concurred with the idea that the sale effected by a controlling shareholder was rather a sale of corporate assets belonging to all shareholders than a mere sale of shares. The minority did not object to a premium resulting from a sale of control, but affirmed it should be shared by everyone. It further dismissed the economic hardship argument, being unconvinced that this would be an inevitable result. Adopting the principles underlying the *City Code*, the minority set aside the legal ground put forward by the majority "[...] since the provisions of the City Code are invariably followed in almost every instance"[83].

The minority also proposed that the consideration offered in the extended offer be identical or alternative in the manner of its payment[84]. A notice to holders of both outstanding shares and debt instruments was also suggested[85]. It then dealt with the "troublesome" meaning of acquisition of control. It adopted the same figure of 20% used in the *1966 Act* and dismissed the idea of suggesting a specific number of people involved in a private agreement before a general offer could be requested[86]. Finally, the minority acknowledged that

> [t]he minority is not unmindful that, in the case of a private agreement, there may, in certain circumstances, be a compelling reason why a general offer need

81. *Id.*, ch. 11, #8.
82. *Id.*, ch. 11, #9.
83. *Ibid.*
84. *Id.*, ch. 11, #10.
85. *Id.*, ch. 11, #11.
86. *Id.*, ch. 11, #12.

not be made. Some flexibility should be provided, as is the case with the City Code, and the Ontario Securities Commission should have the right to order, under proper circumstances, that a general offer need not be made.[87]

25. Several observations arise from each opinion. The first one is related to the proposal that the private agreement exemption be deleted from the *Act* itself. On this point curiously enough, both sides reached the same conclusion not to delete, but for different reasons. The majority saw its removal as a reduction of the incentives which promote the entrepreneurship of businessmen. On the other hand, the minority simply said the exemption was not improper *per se*, but its effects might be regulated to ensure a certain amount of fairness for all shareholders. This latter argument seems a more appropriate way to explain the situation which was facing the Select Committee. In essence, the problem is not the existence of the private agreement exemption, but rather that which results from its use: the premium paid only to controlling shareholders. This payment is the root of the inequality of treatment between controlling and remaining shareholders, not the sale itself[88].

26. The second observation may be seen as a corollary of the first one. Having realized that control was sold through private agreements, the minority said that it would be better to regulate its effects, while the majority focused on the freedom of the controlling shareholder to initiate the transaction by selling his shares. By advancing such opposite opinions, the Select Committee reflected what was taking place in the U.S. where the courts advocated one position and commentators the other[89]. The traditional common law view was shared by both the majority of the Select Committee and most of the American courts. They were in opposition to the minority of the Select Committee and the American theorists who believed that assets as well as shares were sold by the controlling shareholders. It cannot be said that one approach is intrinsically better than the other since each one is based on opposite premises. A choice between them was more of choice of policy and philosophy of regulation than anything else[90].

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87. *Id.*, ch. 11, #13. The minority also talked about an exemption from the proposed follow-up offer in cases of foreign ownership, leaving this point to a further legislative action by the government.

88. See on the actual links between s. 88(2)(c) and 91(1) and the effect of their abrogation *Chairman Report, supra*, note 7, 83A.

89. See *infra*, #30 to #32 and #37 to #40.

90. J.D.A. Jackson, "Control Block Transactions", in *Recent Developments. Securities and Corporate Law. Canadian Bar Association (Ontario)*, May 9, 1980, Part IV, pp. IV-86 to IV-116, pp. IV-90-91 [hereinafter referred to as *Control Block Transactions*]; *Johnston, supra*, note 32, p. 340.

### 2.3. The common law and the sale of control

27. In the U.K. as well as in Canada[91], directors' fiduciary duties are arguably identical to the duties owed by any other fiduciary[92]. One of the historical reasons for which fiduciary rules were applied to directors is that, being responsible for the management of the corporation's property, they were in a situation obviously lending itself to the taking advantage[93] of their control position. A strong body of rigid rules was therefore developed in order to protect beneficial owners from such potential abuses by directors acting as trustees[94].

28. One of the major problems springs from the fact that directors' duties are owed to the corporation and not to shareholders[95]. Even though it has been noted that this rule does not imply that directors can never be viewed as fiduciaries for the shareholders[96], particularly when they breach their duties[97], this rule laid down in *Percival v. Wright*[98] is firmly established in the U.K. and in Canada. Another difficulty arises since it is unclear whether directors' duties, which are applicable also to officers acting on behalf of directors[99], might be applied to controlling shareholders. This difficulty is obviously resolved where majority shareholders are directors as well, but the situation is doubtful where this is not the case[100].

29. It is however arguable under the present case law that both controlling shareholders and directors or officers are under no fiduciary duty while selling a control block at a premium[101]. They are not subject to any

91. See *e.g.* for an abstract of the duties imposed upon Canadian directors F. IACOBUCCI, M.L. PILKINGTON, J.R.S. PRINCHARD, *Canadian Business Corporations*. Toronto, Canada Law Book, 1977, pp. 296 and ff. [hereinafter referred to as *Canadian Business Corporations*]; S.M. BECK, "The Saga of Peso Silver Mines: Corporate Opportunity Reconsidered", (1971) 49 *Can. Bar Rev.* 80, pp. 90–92.
92. L.B.C. GOWER, *Gower's Principles of Modern Company Law*. 4th ed. London, Stevens & Sons, 1979, p. 572.
93. See *e.g.* S.M. BECK, *supra*, note 91, pp. 91, 92.
94. See *Weinberg and Blank*, *supra*, note 10, #210; *Canadian Business Corporations*, *supra*, note 91, p. 293; L.B.C. GOWER, *supra*, note 92, ch. 24.
95. L.B.C. GOWER, *supra*, note 92, pp. 572-73.
96. *Ibid.*
97. See *e.g. Allen v. Hyatt*, (1914) 17 D.L.R. 7, pp. 11-12 (P.C.).
98. *Percival v. Wright*, [1902] 2 Ch. 421; however, it has been held that this case had been wrongly decided by the New Zealand Court of Appeal. See *Coleman v. Myers*, [1977] 2 N.Z.L.R. 225 (NZCA); L.B.C. GOWER, *supra*, note 92, P. 573.
99. L.B.C. GOWER, *supra*, note 92, p. 574.
100. A.J. BOYLE, "The Sale of Controlling Shares: American Law and the Jenkins Committee", (1964) 13 *Int. Comp. L.Q.* 185, p. 188, notes 8–10.
101. *Ibid.*; see also W.P. ROSENFELD, "Corporate Acquisitions", [1972] *L.S.U.C.* 367, pp. 371, 72; *Alboini*, *supra*, note 4, p. 719; *Farnham v. Fingold*, [1972] 3 O.R. 688; (1972) 6 D.L.R. (3d) 97; rev. in appeal on other grounds [1973] 2 O.R. 132; (1973) 33 D.L.R. (3d) 156

duty to disclose such deals and are allowed to keep the premium gained therefrom as well, providing that (in respect of directors or officers only) no unusual circumstances such as fraud on the minority or breach of fiduciary duties occur [102]. In fact, it appears that both the U.K. and the Canadian common law are unlikely to follow American decisions on the sale of control [103], even though it has been suggested that such a view could perhaps eventually be adopted in England [104].

30. The American case law is rather more complex than the Anglo-Canadian one. The general thread of the decisions is called the majority rule. It stresses that, although directors and majority shareholders owe fiduciary duties to their corporation [105] in respect of their management, neither owe such a duty towards minority shareholders when selling their stock [106]. As with any other shareholder, they are free to sell their shares at whatever price they can obtain [107]. The mere ownership of shares is in itself insufficient to create a fiduciary relationship with the minority [108], either as a group or individually [109]. There is also no obligation to disclose [110] either the transaction or its purposes, or to make sure that remaining shareholders will be offered a similar opportunity [111].

31. American courts have however developed theories which allow the recovery of the premium paid to controlling shareholders [112] upon a sale of

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(C.A.); *In the Matter of Consolidated Manitoba Mines Ltd and Great Basin Metal Mines Ltd*, (1966) *O.S.C. Bulletin* 5, p. 8 [December 1966]; *Western Ontario Natural Gas Co. Ltd v. Aikens*, [1946] 4 D.L.R. 647, p. 660 (Ont. H.C.).

102. L.B.C. GOWER, *supra*, note 92, p. 624 and ch. 25 in general; *Canadian Business Corporations, supra*, note 91, pp. 317-18.

103. L.B.C. GOWER, *supra*, note 92, p. 707. It is also interesting to note the difference between the third edition, where the title of ch. 24 includes the expression controlling shareholders, and the fourth edition, where such wording has been dropped.

104. *Id.*, p. 640 and p. 707; see *supra*, #15.

105. See *e.g. Fletcher Cyc. Corp. (Perm. Ed.)* and #838 and #848; *Gerdes v. Reynolds*, 28 NYS 2d 622 (S.C., N.Y. Count., 1941), p. 650, where cases are cited illustrating when majority shareholders have been said to stand in a fiduciary relationship to the minority.

106. See *e.g. Yerke v. Batman*, 376 N.E. 2d 1211, p. 1214 (C.A. Ind., 1978); *Keely v. Black*, 111 Atl. 22, p. 23 (C.A.N.J., 1920); *Roly v. Dunnett*, 88 F. 2d 68, p. 69 (10th Circ. 1937).

107. See *e.g. Clagett v. Hutchison*, 583 F. 2d 1259, p. 1262 (4th Circ., 1978); *Essex Universal Corporation v. Yates*, 305 F. 2d 572, p. 576 (2nd Circ., 1962); *Stanton v. Schenck*, 252 NYS 172, p. 173 (S.C., N.Y. County, 1931).

108. See *e.g. McDaniel v. Painter*, 418 F. 2d 545, p. 547 (10th th Circ., 1969); *Levy v. American Beverage Corp.*, 38 NYS 2d 517, p. 525 (S.C. Ap. Div., 1942).

109. See *e.g. American General Insurance Co. v. Equitable General Corp.*, 493 F. Supp. 721, p. 740-41 (D.C. Virg., 1980).

110. See *e.g. Yerke v. Batman, supra*, note 106; *McDaniel v. Painter, supra*, note 108.

111. See *e.g. Christophides v. Porco*, 289 F. Supp. 403, p. 405 (D.C. N.Y., 1968).

112. See *e.g. Benson v. Braun*, 155 NYS 2d 622, p. 625 (S.C. Sp. Tr., 1956).

control. A minority rule, framed on the fiduciary duties owed by controlling shareholders [113] both to the corporation and to minority shareholders [114], has been developed. This rule stresses that majority shareholders have to respect their fiduciary obligations in transactions affecting the minority.

32. A so-called special facts doctrine was also developed, whereby limited fiduciary obligations are imposed upon controlling shareholders, compelling them to disclose to the minority the purpose of the transactions concluded [115].

33. The general thread discussed above has been narrowed by American courts. In a series of decisions generally known as the looting cases [116], selling shareholders were held liable where it was established that they knew the buyer would loot the corporation's assets upon their resignation. These cases have stressed that where the controlling shareholder has reason to believe that the purchaser is irresponsible or is willing to mismanage and loot the corporation [117], he has to conduct an enquiry to determine the buyer's intention [118] and to refuse to sell if the buyer can be seen to have the effective desire of looting the corporation's assets. The cases have been viewed by commentators as based upon the duty of good faith and due care owed by directors and controllers on the transfer of their shares [119]. They have been explained by the use of tort principles of fraud and negligence [120] rather than

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113. See *e.g. Pepper v. Litton*, 308 U.S. 295, p. 306; 60 S. Ct. 238 (1939); *Southern Pacific Co. v. Bogert*, 250 U.S. 483, pp. 491-92; 30 S. Ct. 533, p. 537 (1919); *Seagrave Corp. v. Mount*, 212 F. 2d 389, p. 396 (6th Circ., 1954).

114. See *e.g. Jones v. H.F. Ahmanson & Company*, 460 P. 2d 464 (1969); *DeBaun v. First Western Bank and Trust Co.*, 120 Cal. Rptr. 354, p. 361 (C.A., 1975).

115. See *e.g. Brown v. Halbert*, 76 Cal. Rptr. 781 (C.A. 1969); L. LOSS, *Securities Regulation*. Supp. 1969. Boston, Little, Brown & Co., pp. 1446-50; *Strong v. Reptile*, 213 U.S. 419; 29 S.Ct. 521 (1909).

116. *Insuranshares Corp. of Del. v. Northern Fiscal Corp.*, 35 F. Supp. 22 (D.C. Pa., 1940); *Gerdes v. Reynolds, supra*, note 105.

117. See *e.g. McDaniel v. Painter, supra*, note 108, p. 547; *DeBaun v. First Western Bank and Trust Co., supra*, note 114, p. 360; *Insuranshares Corp. of Del. v. Northern Fiscal Corp., supra*, note 116, p. 25; *Gerdes v. Reynolds, supra*, note 105, p. 654; *Ritchie v. McGrath*, 571 P. 2d 17, pp. 22, 24 (C.A. Kan., 1977); *Swinney v. Keebler Company*, 480 F. 2d 573, p. 578 (4th Circ., 1973); *Harman v. Willbern*, 520 F. 2d 1333 (10th Circ., 1975). Cases where the seller did not have reasons to believe that the purchaser will loot corporation. See *e.g. Benson v. Braun, supra*, note 112, p. 626.

118. See *e.g.* where an enquiry has to be held see *supra*, note 117. Where an enquiry was held unnecessary, see *Levy v. American Beverage Corp., supra*, note 108, p. 524.

119. N. LEECH, "Transactions in Corporate Control", 104 *U. Pa. L. Rev.* 725, p. 782 (1955-56); "Note : Duties of Controlling Shareholders in Transferring Their Shares", 54 *Harv. L. Rev.* 648, P. 649 and 653 (1940-41).

120. *Benson v. Braun, supra*, note 112, p. 629; R.W. JENNINGS, "Trading in Corporate Control", 44 *Calif. L. Rev.* 1, pp. 8-9 (1956).

in terms of fiduciary relationship; the measure of damages represents the harm suffered by the corporation [121] and perhaps also, the amount paid as premium which had to be returned [122].

34. The sale of corporate office has been another ground upon which the courts have relied in cases of transactions where control has been sold at a premium, accompanied by the resignation of directors and officers. It has been held illegal to sell corporate office [123], to receive money to provide the buyer with immediate control over the corporation purchased [124], or to receive compensation for the loss of office [125]. Such contracts have been declared void, as being contrary to the public interest [126]. Moreover, directors have been held liable in such cases for having breached their fiduciary duties by receiving sums which rightfully belonged to their corporation [127]. It must be noted that in English law, the payment received for the loss of corporate office on a sale of control by private agreement does not fall within s. 193(1) of the *Company Act* [128]. However, in both the U.K. and in Canada, such a payment would constitute a breach of the directors' fiduciary duties [129].

35. Misrepresentations to the minority, as well as diversion of corporate opportunity [130], have also served as grounds for actions against directors and majority shareholders in the U.S.[131] Under specific circumstances and

121. R.W. JENNINGS, *supra*, note 120, p. 9; N. LEECH, *supra*, note 119, pp. 779-80.

122. A. HILL, "The Sale of Controlling Shares", 70 *Harv. L. Rev.* 986, pp. 988-89 (1956-57); N. LEECH, *supra*, note 119, p. 779-80; see also *Benson v. Braun, supra*, note 112.

123. See *e.g. Sugden v. Crossland*, (1856) 65 Eng. Rptr. 620; *McClure v. Law*, 55 N.E. 388 (C.A., N.Y., 1899); *In re Caplan's Petition*, 246 NYS 2d 913, p. 915 (S.C. Ap. Div., 1964); *Gabriel Industries, Inc. v. Defiance Industries, Inc.*, 239 N.E. 2d 706 (C.A., N.Y., 1968); however, sale of office together with sale of shares has been said to be legal in *Essex Universal Corp. v. Yates, supra*, note 107; *Barnes v. Brown*, 86 N.Y. 527 (1880); *Benson v. Braun, supra*, note 112, p. 626; see also R.W. JENNINGS, *supra*, note 120, pp. 19-20 for other cases.

124. See *e.g. Porter v. Healy*, 91 A 428 (S.C. Pa., 1914); *Fletcher Cyc. Corp. (Perm. Ed.), supra*, note 105, #902.

125. See *e.g.* R.W. JENNINGS, *supra*, note 120, pp. 19–22.

126. *Id.*, footnote 181, where the author gives an important amount of cases. See also *Brecher v. Gregg*, 392 NYS, 2d 776, p. 778 (S.C., N.Y. County, 1975).

127. See *e.g. Benson v. Braun, supra*, note 112, p. 626; *McClure v. Law, supra*, note 123, p. 389; *Essex Universal Corp. v. Yates, supra*, note 107, p. 575.

128. L.B.C. GOWER, *supra*, note 92, p. 706; *Weinberg and Blank, supra*, note 10, #2531; *Company Act of 1948*, 11 & 12 Geo. 6, c. 38.

129. L.B.C. GOWER, *supra*, note 92, p. 706; *Weinberg and Blank, supra*, note 10, #2531; *Canadian Business Corporations, supra*, note 91, p. 318.

130. *Perlman v. Feldmann, infra*, note 143; *Essex Universal Corp. v. Yates, supra*, note 107, p. 576.

131. See *e.g.* F.G. O'NEIL, *"Squeeze-outs" of Minority Shareholders: Expulsion or Oppression of Business Associates*. Chicago, Callaghan, 1975, #4.4.

conditions, which differ from the breach of fiduciary duties as used in corporate state law actions, reliance on the federal securities act has been accepted as a basis for liability. S. 10b and Rule 10b-5, s. 14(f) and s. 16(b) of the *Securities Exchange Act* [132] have been used by minority shareholders following sales of control at a premium [133].

36. Beside the courts' development, American commentators have devoted a substantial amount of energy to this topic [134]. They have constructed several theories which attempt to explain why premiums are paid when control is sold and by whom this premium should be claimed. Also, they have tried to find a rationale reconciling the cases dealing with sales of control. It is interesting to note, although unfortunate, that the theories put forth have not generally been adopted by the courts, thereby resulting in two separate schools of thought [135].

37. One of the most important works published on the topic is that of Berle and Means [136]; the authors suggest that control is a valuable asset belonging only to the corporation. Its value is related to the ability of its holder to dominate a property which belongs to others [137]. Professor Berle has subsequently noted that control is neither merely an attribute of stock

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132. *Supra*, note 30.

133. See *e.g.* T. SCHIFF, "Sale of Control: The Equal Opportunity and Forseeable Harm Theories Under Rule 10b-5", 32 *Bus. Law* 507 (1976-77); N. LEECH, *supra*, note 119, pp. 758 and 831; R.L. BROOKS, "Rule 10b-5 in the Balance: An Analysis of the Supreme Court's Policy Perspective", 32 *Hast. L. J.* 403 (1980), see also *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723; 95 S. Ct. 1917 (1975); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185; 96 S. Ct. 1375 (1976); *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462; 97 S. Ct. 1292 (1977); *Chiarella v. United States*; 100 S. Ct. 1108 (1980); *Schlick v. Penn-Dixie Ciment Corp.*, 507 F. 2d 374 (2nd Circ., 1974); *Birbaun v. Newport Steel Corp.* 193 F. 2d 461, cer. den. 343 U.S. 956 (1952) (2nd Circ.).

134. See *e.g.* E.R. HAYES, "Sale of Control of a Corporation: Who Gets the Premium?", 4 *J. Corp. L.* 243 (1979); T.L. HAZEN, "The Sale of Corporate Control: Towards a Three-Tiered Approach", 4 *J. Corp. L.* 263 (1979); R.J. SANTONI, "The Developing Duties of Controlling Shareholders and Appropriate Restraints on the Sale of Corporate Control", 4 *J. Corp. L.* 285 (1979); T.L. HAZEN, "Transfers of Corporate Control and Duties of Controlling Shareholders — Common Law, Tender Offers, Investment Companies — And a Proposal for Reform", 125 *U. Pa. L. Rev.* 1023 (1976-77), T.L. HAZEN, "Premiums in the Sale of Corporate Control", 11 *Inst. Sec. Reg.* 317 (1980); R.W. JENNINGS, *supra*, note 120; N. LEECH, *supra*, note 119; A. HILL, *supra*, note 122; A.A. BERLE, "'Control' in Corporated Law", 58 *Colum. L. Rev.* 1212 (1958), A.A. BERLE, "The Price of Power: Sale of Corporate Control", 50 *Cornell L.Q.* 628 (1964-65), D.C. BAYNE, *infra*, note 140; W.D. ANDREWS, *supra*, note 14.

135. See *e.g.* *McDaniel v. Painter*, *supra*, note 108, p. 548.

136. A.A. BERLE, G. MEANS, *The Modern Corporation and Private Property*. New York, MacMillan Co., 1933 and 2nd ed. 1968.

137. *Id.*, p. 244.

ownership nor a thing, but rather a function; the holder of a control position therefore occupies a power position [138]. Such a position is a corporate asset, not an individual one [139]; the money paid for it should be returned to the corporation.

38. Professor Bayne, in the course of a substantial number of articles [140], has taken a "moralist approach" [141]. He has developed the concept of "controleur", a person being subject to strict fiduciary duties. The "controleur"'s major task is to select a suitable successor. The premium paid on a sale of control is described as a "premium-bribe"; its acceptance is viewed as a breach of fiduciary duty. The premium therefore has to be paid back.

39. A third general approach which has also been proposed is attributed to Professor Andrew. He has suggested that

> [...] whenever a controlling stockholder sells his shares, every other holder of shares (of the same class) is entitled to have an equal opportunity to sell his shares, or a prorata part of them, on substantially the same terms. Or in terms of the correlative duty: before a controlling stockholder may sell his shares to an outsider he must assure his fellow stockholders an equal opportunity to sell their shares.[142]

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138. A.A. BERLE, *supra*, note 134, p. 1215 [58 *Colum. L. Rev.*].

139. *Ibid.*

140. D.C. BAYNE, "A Philosophy of Corporate Control", 112 *U. Pa. L. Rev.* 22 (1963-64); "Corporate Control as a Strict Trustee", 53 *Geo. L.J.* 543 (1964-65), "The Sale of Corporate Control", 33 *Fordham L. Rev.* 513 (1964-65); "The Definition of Corporate Control", 9 *St-Louis U.L.J.* 445 (1964-65); "The Sale-of-Control Quandary", 51 *Cornell L.Q.* 49 (1965-66); "The Sale-of-Control Premium: The Intrinsic Illegitimacy", 47 *Tex. L. Rev.* 215 (1968-69); "The Sale-of-Control Premium: The Definition" 53 *Minn. L. Rev.* 485 (1968-69); "The Sale-of-Control Premium: The Disposition", 57 *Calif. L. Rev.* 615 (1969); "A Flaw in the Law: The Demand Rule: A Brief", 22 *St. Louis U.L.J.* 69 (1978-79); "A Legitimate Transfer of Control: The Weyemberg Shoe-Floresheim Case Study", 18 *Stan. L. Rev.* 438 (1965-66). See G.A. LEWIS, "The Legitimate Transfer of Corporate Control: A Paradigmatic Study of the Custodial Concept", 13 *Creighton L. Rev.* 463 (1979-80) for an application of Bayne's theories.

141. See T.L. HAZEN, *supra*, note 134, p. 271 [4 *J. Corp. L.*].

142. W.D. ANDREWS, *supra*, note 14, p. 515. Professor Jennings suggested the same thing; see *supra*, note 120, p. 31; N. LEECH, *supra*, note 119, p. 839; A. HILL, *supra*, note 122, p. 1017 also agrees but underlies economic difficulties of doing a general offer in certain circumstances. He also qualified the rule as a blanket rule, p. 988. For Professor BERLE, *supra*, note 134 [50 *Cornell L.Q.* 628] a general offer is a remedy, not a right, p. 639. In Canada, a general offer was also viewed as positive. See *Canadian Business Corporations*, *supra*, note 91, pp. 450–61. For another criticism of equal opportunity rule, see G.B. JAVRAS, "Equal Opportunity in the Sale of Controlling Shares: A Reply to Professor Andrews", 32 *U. Chi. L. Rev.* 420 (1964-65). American practitioners howerver suggest to their clients to make an equivalent offer to remaining shareholders when such is possible. See P.L.I. *Acquisitions 1978*, 169.

40. One of the most analysed decisions related to the sale of control is the Second Circuit court case of *Perlman v. Feldmann*[143], where Feldmann was held liable to the minority shareholders for the premium he received on the sale of his control block. This case has generally been viewed as sustaining the sale of asset theory put forth by Berle and Means[144]; however, the decision has also been said to fall within the looting case category[145], or to be a loss of corporate opportunity. Many commentators have agreed on the fact that the decision heavily relied upon the specific facts of the case, *i.e.* the Korean War and the associated steel shortage. The decision is also considered as the major factor which prompted most of the sale of control literature in the U.S.

41. The impact of the American situation has undeniably influenced legal development in Canada. Even though it has been suggested that a full application of *Perlmann* was unlikely in Canada[146], the sale of asset theory has been specifically used in two cases. In *Great Basin*[147], a 1966 OSC decision dealing with a transfer of control shares in escrow, the Commission made an implicit reference to *Perlman* when it noted that the real asset of Great Basin was its cash position. This reference to the *Perlman* case becomes even more evident in light of the Commission's statement by which it said that "in a period of tight money this (the cash asset) places the company in a strong bargaining position"[148]. Later, the OSC also discussed issues similar to those raised in the U.S.; the sale of a control block being not merely a sale of shares, but also the sale of the control over the board of directors, the sale of the corporate asset, the breach of fiduciary duties following the looting of the corporation by the purchaser and finally the loss of a corporate opportunity. Furthermore, the Commission suggested that giving an equal opportunity to non-controlling shareholders would be an equitable practice. The application was refused, but the OSC noted that it was without prejudice to a further application, following either an offer to remaining shareholders, or the approval of those shareholders together with a full disclosure of all material facts related to the future plans of the applicant.

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143. 219 F. 2d 173 (2nd Circ., 1955) cer. den. 349 U.S. 952 (1955).
144. A.A. BERLE, *supra*, note 134, p. 1221 [58 *Colum. L. Rev.*]; but see R.W. JENNINGS, *supra*, note 120, p. 9, note 33 and N. LEECH, *supra*, note 119, pp. 810, 11 for opposite opinions.
145. See *e.g.* W.D. ANDREWS, *supra*, note 14, pp. 509 and ff; A. HILL, *supra*, note 122, pp. 989, 90.
146. *Alboini, supra*, note 4, p. 716.
147. *Supra*, note 101.
148. *Id.*, p. 9.

42. It is interesting to note that the *Great Basin* decision contains many of the actual elements found both in s. 91(1) and in *Policy 3-41* [149]. The OSC said that an equal opportunity was a good corporate practice, even though Ontario law was not settled in respect of the obligations owed by the controlling shareholders. It also declared that the protection of the shareholders where the law appeared to be unclear, and that the Commission was not bound by the strict rules of corporate law, were tasks performed "in pursuance of its obligation to protect the investing public" [150]. It further stressed that rigid rules were undesirable, and that it "might be economically wrong to adopt rules which would prevent the removal of ineffective management" [151].

43. In the case of *Farnham* [152], the Ontario High Court faced a situation somewhat similar to that in *Perlman* and in *Brown v. Halbert* [153]; this case was however settled before being tried. An offer was made to acquire the control of Slater Steel, at a premium. The control group of insiders and directors accepted the offer and, without disclosing any information to the shareholders, bought as many shares as possible on the public market with the view to enhance their profit on the sale of their control block. To avoid the takeover bid regulations, they artificially lowered the number of their group to less than fifteen, in order to take advantage of the private agreement exemption. A class action was launched on behalf of the shareholders alleging conspiracy and breach of fiduciary duty. A declaration that the premium obtained was owed to the corporation was also sought. A motion to dismiss the action succeeded on appeal on the basis that a derivative action rather than a class action should have been initiated. The Court of Appeal noted that

> [t]he claims made in the statement of claims are completely novel. Their success may depend on the trial Court applying or extending the principle followed in *Perlman v. Feldmann* (1955), 219 F. 2d 173, and *Brown v. Halbert* (1969), 76 Cal. Rptr. 781, or on the trial Court holding that a breach of the provisions of Part IX of the *Securities Act*, R.S.O. 1970, c. 426, constitutes an actionable civil wrong. As I appreciate the appellants' argument, they do not now challenge Morand, J.'s decision that the difficult questions of law raised by the novelty of the plaintiff's claims should not be determined in interlocutory proceedings, and their attack on the form of the action and the statement of claim is confined to matters not specifically dealt with in the judgment below.[154]

149. The major difference is that s. 91(1) prescribes to the *purchaser* and not the *seller* of the control block to make an equivalent offer; see *infra*, ch. 4.
150. *Id.*, p. 11.
151. *Id.*, p. 10.
152. *Supra*, note 101.
153. *Supra*, note 115.
154. *Supra*, note 101, pp. 133-34 (C.A.).

44. It is important to note that Ontario did not attempt to remake the American common law, nor did it solve the entire range of problems pointed out by U.S. commentators in the literature on sale of control. The Ontario legislation on the follow-up offer does not regulate transactions and the information which has to be disclosed when an insider buys stock to increase his profit before the sale of his control block. Neither does the legislation attempt to impose upon controlling shareholders fiduciary duties when selling their shares [155]. Indeed, Ontario has done only one thing by introducing s. 91(1): it has provided the remaining shareholders with a means to ensure equality of treatment where control of a corporation is sold at a premium.

### 3. The mechanism of the follow-up offer

#### 3.1. The private agreement

45. Where a private agreement is concluded with less than fifteen security holders, and where the price paid for the securities is 15% above the market price as defined in the *Act*, the offeror must make an equivalent offer within 180 days of the date of the agreement to the remaining holders of the same class of securities [156].

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155. See however the OSC interpretation in *McLaughlin, supra*, note 3.

156. The actual wording of s. 88(2)(c) has been extensively broadened. The word *shares* has been replaced by *securities*, thereby considerably expanding the scope of application of the private agreement. The expression *shareholder* was similarly replaced by *security holders*. Finally, the single word *agreements* was substituted for the expression *private agreement*. A similar exemption is found in the *Canada Business Corporation Act*. S.C. 1974-75, c. 33, s. 187(a) [hereinafter referred to as the *CBCA*]. The Federal text is simpler than the Ontario one, although directed to the same purpose. *Share* is defined as a share which carries a general or specific voting right, as well as a security currently convertible into such a share, and an option and right to acquire either such share or convertible security. The word *shareholder* is also narrower than the expression *security holders* as used in the Ontario statute. The expression *separate agreements* is used in the Federal text, Ontario having preferred the word *agreements* alone; but the effect seems to be the same. Finally, the *CBCA* omits reference to an offer not made to shareholders generally, a statement having been criticized as troublesome, and omits reference to any counting rule.
The *Québec Working Paper* decided to propose a definition of private agreement which is framed on the Ontario section and on the second "counting rule". The text reads as follows:

> An offeror who makes a take-over bid is exempt from the requirements of this Part where [...] the bid is not made to security holders generally and envisages the purchase of securities by way of separate agreements with not more than five security holders, with the reservation that where the securities have been acquired within the two preceding years for resale under this exemptions, [sic] each seller from whom they were purchased under the bid must be counted as a holder;

See *Québec Working Paper, supra*, note 23, s. 106(2).

One of the features of the *1978 Act* is that the private agreement has become an exempted takeover bid rather than being an exempt offer as in the *1966 Act.* While the actual wording of the takeover definition does not include any exemption of any kind, a second section of the *Act* provides that a takeover bid will be exempted from the requirements of Part XIX where such takeover is an offer to purchase securities by way of private agreement [157].

46. This slight difference in wording has many implications. The first is linked to the qualification of a transaction as being a takeover bid, regardless of the number of voting securities involved and the ownership resulting thereof. Obviously, if no takeover bid occurs, no private agreement as understood under the *1978 Act* will exist.

In the Atco [158] case for instance, the Commission took into account both the substance of the transaction and the broad wording of s. 88(1)(k)(i) [160]. One commissioner, relying on a strict interpretation of the expression *the other issuer*, dissented from the Commission [161].

In the *Turbo case*, the OSC ruled that a private agreement followed by a stock exchange takeover bid had to be regarded as one takeover for the

157. *1978 Act, supra*, note 1, s. 88(2)(c). This is not the case in the CBCA.

158. *In the Matter of Atco Ltd. IU International Corporation Canadian Utilities Ltd*, (1980) *O.S.C. Bulletin* 412 (Sept.) [hereinafter referred to as *Atco*].

On May 12, 1980, Atco entered into an agreement with IU International Corporation, incorporated under Maryland Law, to exchange IU common shares owned by Atco for 12,093,670 Canadian Utilities Limited shares beneficially owned by IU. This amount represented 58.1% of the outstanding CU common shares. On the date of the agreement, Atco was not in possession of any IU common shares; an offer was then made both in the U.S. and in Canada to acquire the necessary amount of shares. The U.S. tender offer requirements were followed but Atco filed an application with the OSC under s. 99(e) to seek a ruling declaring the Atco acquisition exempted from the requirements of the takeover bid section of the *1978 Act*, as well as a ruling declaring the agreement concluded on May 12 to be exempted therefrom. The first request was granted, but a second hearing was held on the other ruling sought by Atco.

Counsel for Atco first argued that no takeover bid as defined in Ontario had taken place because IU, the only shareholder of CU involved in the transaction, had no address in Ontario as a shareholder of CU. Counsel further submitted that even though the tender offer made for IU shares was a condition for the completion of the May 12 agreement, such an offer could not lead to the conclusion

> [...] that ATCO's subsequent acquisition of CU stock involves a takeover bid because the minority shareholders who would be the recipients of a follow-up offer under section 91 would be the minority shareholders of CU not IU and, in any event, all IU shareholders are receiving ATCO's tender offer. [p. 415]

159. *Id.*, p. 416. See also *Pacific Coast Coin Exchange v. The Ontario Securities Commission*, [1978] 2 S.C.R. 122, p. 127.

160. *Atco, supra*, note 158, p. 417.

161. *Id.*, pp. 425–27; see *infra*, #49.

purchase of the Merland shares [162]. So far, the Commission has relied upon the intent of the purchaser while making his offer as well as the outcome of the overall transaction in deciding whether a takeover bid has been made.

47. A second implication of the difference in wording arises in connection with the residence of the security holders to whom a takeover bid is proposed. The Ontario legislation applies as soon as an offer is made to a security holder whose address in the books of the offeree corporation is in Ontario. If this is not the case, all other criteria become irrelevant: such an offer will not fall within the definition of takeover bid [163].

A more difficult situation arises from the second part of the takeover bid definition, which deals with the acceptance of an offer to sell. Simply stated, the issue is whether or not the shareholder accepting an offer and selling his shares must have an address in Ontario [164]. Such acceptance is deemed to be an offer; the shareholder accepting is deemed to be an offeror, thereby referring to the first part of the definition, the offer to purchase. On the other hand, the person who has initiated the acceptance is deemed to be an offeree. Therefore, if this offeree does not have an address in Ontario, there would be no takeover bid as defined by s. 88(1)(k) [165]. Indeed, s. 88(1)(k)(ii) would be of some effect only between Ontario residents [166]. The argument by which no Ontario address is required to bring s. 88(1)(k)(ii) into play seems doubtful in such a context [167].

48. A third implication of such difference in wording is related to the amount of voting securities which may be sold through private agreement. As long as the threshold of 20% of ownership is not reached, the transaction will not qualify as a private agreement falling under s. 88(2)(c). In other words, a sale whose result for the purchaser is an ownership of less than 20% will not be a takeover bid, nor will it fall within the definition of a private agreement. On the other hand, a resulting holding of 20% or more will bring the takeover bid definition into play. Such transaction, if properly qualified as a private agreement, will be exempted from Part XIX of the *1978 Act* [168], but subject to s. 91(1).

162. See *Turbo case* [reasons], *infra*, note 212, p. 82C. The case is discussed *infra*, # 109 and ff.

163. *1978 Act, supra*, note 1, s. 88(1)(k) and 88(2); see *Alboini, supra*, note 4, p. 729.

164. That part of the definition will be deleted in the new definition of takeover bid. See (1981) 2 *O.S.C.B.* 80A(13 nov.).

165. *Alboini, supra*, note 4, p. 729. He also notes that the same appears to be true in respect of s. 88(1)(k)(iii).

166. See notes 163 and 165; see also P. Anisman, P.W. Hogg, "Constitutional Aspects of Federal Securities Legislation", *Proposals Tome 3, supra*, note 22, 135, p. 150, note 74. See *infra*, 4.2.3.

167. Such an argument was refused by the dissenting commissioner in *Atco* and not discussed by the majority. See *Atco* case, *supra*, note 158, p. 428.

168. *1978 Act, supra*, note 1, s. 88(1)(k) and 88(2); see also *Alboini, supra*, note 4, p. 723.

49. From those implications, it is already obvious that close relations exist between takeover bids and private agreements. Indeed, a private agreement is no longer viewed solely as a sale of control, but rather as an acquisition of shares through a public offer, the private agreement being a manner to avoid the rules laid down in the *1978 Act*[169]. The direct consequence thereof is that holders of the same class of securities may not be treated the same way where one attempts to takeover their company. Put in a different way, ss. 88(2)(c) and 91(1) have become more a question of equality of treatment among shareholders than anything else. It has been correctly pointed out in the *Interim Report* that the follow-up offer was a device through which new rights were conferred to minority shareholders[170]. That the "evil" of paying a premium on a sale of control is not the sole feature sustaining s. 91(1) appears therefore somewhat obvious; that this is what people were expecting from the *1978 Act* is much less clear. In any event, to confer more rights to the minority in takeover situations is not an isolated event in the evolution of securities legislation[171]. It appears the real question is whether that evolution is still desired by participants in the Ontario marketplace.

### 3.1.1. Conditions of application

#### 3.1.1.1. An offer to purchase

50. Before s. 88(2)(c) is applicable, an offer to purchase must exist. Because the private agreement exemption is an exempted takeover bid, the above discussion of an acceptance as it is deemed to be an offer to purchase will apply in respect of s. 88(2)(c). It would otherwise be too easy to attempt to avoid the application of the section by seeking only acceptance without making any offer to potential purchasers[172]. The wording of the section being broad, an offer to purchase may be practically anything, from a phone call to a formal written contract sent to shareholders. It seems that the section does not consider the form used to transmit the "information" or "offer", but rather its substance.

#### 3.1.1.2. Securities

51. The offer is made for the purchase of securities, an expression being a little troublesome. *Security* is a defined term whose meaning is broad

169. See *e.g.* the remarks made by the OSC Chairman in the *Chairman Report, supra*, note 7, p. 82A.
170. See *Interim Report, supra*, note 16, p. 229A.
171. See *supra*, #14 and ff.
172. Such explanation was put forth by the dissenting commissioner in *Atco, supra*, note 158, pp. 428-29.

and almost unrestricted[173]. When taken in connection with the definition of *published market*[174], the resulting effect seems to be that s. 88(2)(c) will apply as soon as any type of the offeree's securities are sold by fewer than fifteen holders. However, there are two arguments opposing such an interpretation.

52. Firstly, one has to bear in mind that the private agreement exemption has to be viewed in the context of an exempted takeover bid, which transaction is restricted to voting securities. Such a term is defined in s. 1(1)(44) of the *1978 Act*. A private agreement, to fall within the definition set out in s. 88(2)(c), should then be made in relation to voting securities[175].

Secondly, it is hard to imagine a case in which a sale of control is effected through a private agreement without the transfer of voting stock. The use of the word *security* may be explained by the fact that the private agreement exemption was not primarily designed to allow a sale of control, although such is the purpose for which it was used[176]. To sell control, nothing but voting securities must be transferred. Practically speaking therefore, only such securities will be exchanged and not just any type of security as the word may imply.

53. If s. 88(2)(c) is not restricted to voting securities, the requirement of the follow-up offer might be avoided by relying upon s. 99(a), such a private agreement being not a sale of control[177].

### 3.1.1.3. By way of agreements

54. The offer to purchase securities is concluded by way of agreements. The *1978 Act* has clarified a confusing situation. The *1966 Act* used the term

173. See *e.g.* N.N. Antaki, "Le contrat de placement de fonds; une valeur mobilière envahissante", (1978) 19 *C. de D.* 903; F. Iacobucci, "The Definition of Security for Purposes of a Securities Act", *Proposals Tome 3, supra*, note 22, p. 221.

174. *1978 Act, supra*, note 1, s. 88(1)(j); see *infra*, # 77.

175. Alboini has suggested than an option is not included in the definition of voting securities. However, this expression refers to "any *security*, other than a debt security"; *1978 Act*, s. 1(1)(44) [emphasis added]. The use of the word *security* refers to s. 1(1)(40), where *security* is defined. Such a word includes an "option [...] or other interest in or to a security", *1978 Act*, s. 1(1)(40)(iv). *Alboini, supra*, note 4, p. 723. See also s. 103(1) which set up compulsory disclosure of information when an acquisition by an agreement results in an ownership superior to 20% for a purchaser. In respect of non-voting or multiple voting securities, see *Non-voting Securities: The Toronto Stock Exchange Request for Comments*, (1980) *OSC Weekly Summary*, Supp. X-2, Oct. 10, and O.S.C. Interim Policy 3-58 and 3-59 (1981), 1 *O.S.C.B.* 36E (June 26); *Addendum No. 1*, (1981) 2 *O.S.C.B.* 1E (July 10). *Addendum No. 2*, (1981) 2 *O.S.C.B.* 26A and 14E (Aug. 7); O.S.C. Interim Policy 3-58 *Restricted Shares (Uncommon Equities) Distributions and Disclosure*, (1981) 2 *O.S.C.B.* 77E (Nov. 20); O.S.C. Policy 3-58, (1982) 3 *O.S.C.B.* 1E (Jan. 22).

176. *Supra*, # 17.

177. See *infra*, # 149 and ff.

*private agreement* without defining it [178], thereby creating some difficulties. It was not clear whether all the vendors had to enter into the same agreement, or whether separate agreements were allowed [179]. The difficulty became even greater when the *CBCA* used the expression *separate agreements* [180], even though this expression was itself subsequently criticized as being ambiguous [181]. Moreover, *private agreement* was used in contrast to *shareholders generally* in an attempt to denote a takeover by way of private agreement [182].

55. The *1978 Act*, acknowledging many of the criticisms made, does not contain the word *private* anymore, but simply uses the expression *agreements*. Although this word is also undefined, it might be broad enough to include any type of agreement whereby securities are exchanged. An example of such a broad interpretation was indeed given by the Commission during the takeover bids by both Noranda and BCRIC for the acquisition of MacMillan Bloedel Ltd, of Vancouver [183]. Within the course of the offers, the two bidders attempted to increase their holdings in MacMillan Bloedel Ltd by special tactics effected through the private market and stock exchanges' floor. In a decision released early in April 1981, the Commission said it considered "[...] crosses, put-throughs and any other prearranged trades [as] a form of private agreement" [184]. A formal order was then issued pursuant to s. 124(1) of the *1978 Act* denying the application of s. 88(2)(c) to any takeover of MacMillan Bloedel Ltd shares made by BCRIC, Noranda or their affiliates [185].

#### 3.1.1.4. With fewer than fifteen security holders

56. The offer to purchase securities by way of agreements is restricted to fewer than fifteen security holders. If fifteen or more people are parties to

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178. See R.L. FALBY, "Take-Over Bids and the Ontario Securities Act of 1966", (1967) 5 *Osgoode Hall L.J.* 227, p. 229, where a definition of private agreement has been suggested.
179. See *Alboini, supra*, note 4, pp. 684-85; *Anisman, supra*, note 32, p. 37; *Johnston, supra*, note 32, pp. 215-16.
180. *CBCA, supra*, note 156, s. 187.
181. See *Proposals tome 2, supra*, note 22, p. 122.
182. See *Anisman, supra*, note 32, pp. 41-43; D.D. PRENTICE, *supra*, note 59, pp. 332-33 and 341; see *infra*, #63, #64.
183. The initial bid was launched by BCRIC on March 11, 1981, see *The Globe and Mail*, March 11, 1981, B-1, and until June 1981.
184. *In the Matter of MacMillan Bloedel Ltd, Noranda Mines Ltd and British Columbia Resources Investment Corp.*, (1981) 1 *O.S.C.B.* 106B (April 10); D. WILLOUGHBY, "BCRIC, Noranda limited to public trading in MB", *The Globe and Mail*, April 7, 1981, B-2; see *infra*, #66 and #72.
185. *Id.*, p. 107B.

the transaction, the exemption will not apply. This "fourteen-men rule" [186], although apparently simple, raises some difficulties.

57. Firstly, nothing is said about the residence of the sellers. Both Anisman [187] and Johnston submitted that s. 81(b)(i) of the *1966 Act* would apply only to Ontario shareholders selling their shares and not to those living outside Ontario [188], even though the result would be that more than fifteen shareholders in total could be parties to the private agreement. Another author has simply stated

> [t]he limitation likely applies regardless of the residence of the holders as it does not appear to have been the intent to permit an offeror to rely on the private agreement exemption in the Act and in the legislation of other jurisdictions to conclude agreements with up to 14 security holders in each jurisdiction.[189]

The explanation put forward both by Professors Anisman and Johnston would appear very sound where the private agreement was an exempt offer. Now that it is an exempted takeover bid, the idea that the "fourteen-men rule" applies regardless of the sellers' residence sounds logical, as long as at least one security holder to whom the offer is tendered has his address in the offeree's books in Ontario. The offeror must therefore be very careful where his offer is made in other provinces or in other countries at the same time it is tendered to Ontario security holders.

58. Secondly, new counting rules were introduced in the *1978 Act* to restrict the various possible ways of avoiding the application of the "fourteen-men rule". They are designed to provide solutions to practical problems encountered in calculating the number of purchasers to whom the private agreement can be offered. For these two rules, the burden to establish their availability lies with the offeror, who has to make a reasonable enquiry. If, by this enquiry, he ought to know the facts raising the application of the counting rules, such knowledge will be presumed. It is unclear what has to be understood by a reasonable enquiry and in which circumstances the "ought to know test" will apply. The key word is obviously *reasonable*; this implies an objective test, which will be applied on the facts of each individual case where one of the counting rules applies.

186. See *Control Block Transactions, supra*, note 90, p. IV-94.
187. *Anisman, supra*, note 32, p. 42.
188. *Johnston, supra*, note 32, p. 325. He raised serious doubts about the Ontario's power to regulate transactions which take place outside of its borders. Therefore, the number of fifteen should be regarded as relevant only for the amount of purchases involved in Ontario. See on the constitutional aspects and the powers for the provinces to regulate "extraterritorial" transactions, P. ANISMAN, P.W. HOGG, *supra*, note 166, pp. 143-53.
189. *Alboini, supra*, note 4, p. 685.

59. The first rule is contained in s. 88(2)(c)(i) and clears up an ambiguity found in the *1966 Act*. As stated by Alboini,

> [u]nder the Old Act, it was not clear whether fewer than 15 shareholders (now security holders) meant fewer than 15 registered shareholders or beneficial owners, particularly where a registered shareholder was acting on behalf of his beneficial owners.[190]

Every direct beneficial owner of the securities has to be counted where an agreement [191] exists among them. The obligation to include them arises where the offeror deals with a registered securities holder acting as a trustee, an executor, administrator or other legal representative.

This new rule will prevent the use of a trust or any other legal scheme in an attempt to be included as one of the fourteen. For example, more than fourteen security holders might have deposed their shares under a trust, such a trust appearing as one holder upon the sale of the shares [192]. The duty to discover such a device lies with the offeror. He must first know whether the seller is acting as a representative and, if so, the number of beneficial owners represented [193].

60. Two exemptions are provided to the rule. An *inter vivos* trust established by a single settlor is excluded. This exemption presumably assumes

> [...] that the settlor has settled the shares on the trust personally. Since he could have sold them directly and counted as a single shareholder, it does seem inappropriate to include all of the beneficiaries under the trust in the number of shareholders subject to the agreement.[194]

The second exemption applies where an estate "[...] has not been vested in all persons beneficially entitled thereto" [195]. In such a case, the estate is viewed as being a single security holder as long as every person having a right in the will is unable to exercise or benefit from such a right. One of the results of this exemption was described as creating an onerous duty upon the trustee to dispose of the control block before the estate becomes fully vested, to avoid the counting rule [196]. A potential conflict was thus seen between the

190. *Ibid.*
191. Such an agreement includes a trust, an estate or other type of arrangement. See *Control Block Transactions, supra*, note 90, p. IV-94.
192. *Ibid.; Alboini, supra*, note 4, p. 685.
193. *Alboini, supra*, note 4, pp. 685-86.
194. *Control Block Transactions, supra*, note 90, p. IV-95. Two examples of such transactions are explained in *Alboini, supra*, note 4, p. 686.
195. *1978 Act, supra*, note 1, s. 88(2)(c)(i).
196. See *Control Block Transactions, supra*, note 90, p. IV-95; *Alboini, supra*, note 4, p. 686, gives an example which explains how the rule works.

best interest of the beneficiaries on the one hand and the fiduciary responsibilities of the trustee on the other.

61. Generally speaking, the first counting rule is designed to solve very practical situations encountered in the past. The language used is relatively clear, although the expression *other legal representatives* was seen as creating some difficulties of interpretation. As underlined by Alboini, there is some question as to whether the *ejusdem generis* rule would restrict the meaning of *other legal representatives* to the preceding words of the section.

The effect of such an interpretation would be to restrict the scope of application of s. 88(2)(c)(i) [197]. It must be noted however that the OSC seems unwilling to be caught by a literal or technical interpretation of the private agreement exemption, as well as the follow-up offer requirement [198].

62. A second counting rule is found in s. 88(2)(c)(ii) and is alternative to the first. In short, the purchaser of a control block must discover whether the securities sold to him were acquired by the seller with the view to resell them through the private agreement exemption. The two years immediately preceding the agreement date must be investigated. If such is the case, each prior vendor must be counted. The rule is designed to prohibit schemes whereby sellers attempt to lower their number to fewer than fifteen security holders. This was indeed the case in *Farnham* [199] and in *R v. Littler* [200], the latter being a criminal case dealing with charges of fraud.

The second counting rule will apply whenever the first rule is inapplicable. The purchaser will have to hold a reasonable enquiry to know whether the securities were gathered by the seller "[...] with the intent that they should be sold under such agreement" [201]. As was noted, "[i]t is always a difficult matter where a party's reliance on an exemption depends upon another's intention" [202]. Where the securities sold were not acquired with such an intention, the prior vendor will not have to be counted as being one of the fourteen. Alboini also suggested that the rule would have to be respected only if the securities were bought to be sold to a specific offeror [203]. Without any clear indication of what a *reasonable enquiry* is, the second counting rule might be found to be much more vague than it may initially appear.

197. *Alboini, supra*, note 4, pp. 686-87.
198. See *e.g. Atco, supra*, note 158.
199. *Supra*, note 101.
200. (1974) 41 D.L.R. (3d) 523; (1976) 65 D.L.R. (3d) 443 and 467 (Québec C.A.).
201. *1978 Act, supra*, note 1, s. 88(2)(c)(ii).
202. *Alboini, supra*, note 4, p. 687.
203. *Ibid.*

### 3.1.1.5. Not made to security holders generally

63. The last component of s. 88(2)(c) stipulates that the offer is not made to security holders generally. The word *generally* has been the object of many discussions and interpretations. It was unknown in which cases an offer was not made to shareholders generally: whether it was an offer made to less than fifteen security holders [204], or made to more than fifteen but concluded with fewer than fifteen [205]. An analogy with the public distribution of securities was also proposed [206]. The deletion of the word *generally* and its replacement by a specific number was suggested as well by Anisman to remedy this lack of clarity.

64. The fact that the private agreement is an exempted takeover bid is not of much assistance. It is obvious that the offer required by s. 89(1)(1) of the *1978 Act* is an offer made to shareholders generally. Such a pattern does not have to be followed where a sale by private agreement is concluded [207]; but it is still unclear how many people may be contacted before the offer qualifies as having been made to security holders generally. A comparison may be drawn with the seed capital offering [208], which exemption limits the number of investors to be contacted to fifty, or seventy-five in the case of certain qualified tax shelters [209]. However, it remains merely a comparison. The only thing which could be said with confidence is that the *1978 Act* adopts the approach of regulating only the result of the offer (*i.e.* those concluded with fewer than fifteen people) and leaves aside the number of people to whom the offer may be proposed. It is likely that the *Act* was intentionally left uncertain in respect of this point in order to give flexibility to offerors.

### 3.1.2. Private agreement, takeover bid and equality of treatment

65. The introduction of a follow-up offer as a legal requirement following a sale of control made through an agreement was a response to a certain inequality of treatment existing between majority and minority security holders [210]. At the time this mechanism was introduced, the private

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204. D.D. PRENTICE, *supra*, note 59, p. 333.
205. *Anisman, supra*, note 32, p. 43.
206. D.D. PRENTICE, *supra*, note 59, pp. 333-34.
207. See *Notice Re: Take-Over Bids Private Agreements not Permitted While Bid Through Offering Circular Outstanding*, (1981) 2 *O.S.C.B.* 19A (July 17) [hereinafter referred to as *July 17 Notice*].
208. *1978 Act, supra*, note 1, s. 71(1)(p); see N.N. ANTAKI, G. LECLERC, *supra*, note 63.
209. *Regulation Made Under The Securities Act, 1978.* R.R.O. 1980 Reg 910, s. 14(e), (f), (g), [hereinafter referred to as *Regulation*]. See (1981) 2 *O.S.C.B.* 80A (Nov. 13).
210. See *supra*, introduction.

agreement exemption was used to acquire control from a specific group of individuals without tendering the same offer to the remaining security holders. Through such a device, one group was given an advantage while the other group was deprived of an equal opportunity[211]. On the other hand, a public takeover bid was another method of acquiring such control, this time an offer being made to all security holders. These two transactions, private agreement and takeover bid, were indeed used for the same general purpose, but very seldom were they utilized in conjunction with each other.

66. The market situation then evolved. Since the late seventies, "takeover fever" has hit the North American marketplace, with the result that a tremendous amount of corporations have been either offerees or offerors. Private agreements began to be used along with takeover bids[212], or together with the stock exchange or private company exemptions. These schemes resulted in an inequality of treatment between security holders. In short, different considerations were paid to specific groups who were willing to tender their shares[213]. For instance, market purchases through a stock exchange while a partial takeover bid had been launched was a way to provide an advantage to market sellers. A private agreement concluded prior to a takeover bid, with a consideration smaller than the one paid in the agreement, was another way to give specific groups a financial advantage for the sale of the same securities.

Such manœuvres were obviously designed to go against the concept of equality of treatment between security holders[214]. In Ontario, this concept underlies s. 89(3), 91(1) and s. 91(3) of the *1978 Act*. The latter states that all holders of the same class of securities must be offered the same consideration

211. See *supra*, # 14 and ff.

212. See *supra*, note 184 and #55; *July 17 Notice*, *supra*, note 207. The takeover bid fight between First City Financial Corp. and Genstar for the control of Canada Permanent Mortgage Corp. was a transaction where private agreements were extensively used. See *infra*, #72, and see J. Willoughby, "Genstar warned on private deals", *The Globe and Mail*, July 15, 1981, B-8; "Equivalency is issue in Belzberg follow-up", *The Globe and Mail*, July 21, 1981, B-1; see also *In the Matter of Genstar Corporation* [notice of hearing], (1981) 2 *O.S.C.B.* 62A (Oct. 16); *In the Matter of First City Financial Corporation Ltd and 240083 B.C. Ltd*, (1981) 2 *O.S.C.B.* 185B (Oct. 16); *In the Matter of Turbo Resources Limited, Merland Explorations Limited and Bankeno Mines Limited*, (1982) 3 *O.S.C.B.* 67C (March 26) [reasons] [hereinafter referred to as *Turbo case*, followed by the appropriate qualification ([order] [ruling] etc.)]. The OSC issued between July and March 1982 not less than twelve different statements in respect of this case.

213. See *July 17 Notice*, *supra*, note 207; J. Willoughby, "First City loses its private deals option in vying for Canada Permanent Control", *The Globe and Mail*, July 22, 1981, B-7. See *infra*, #72.

214. See *e.g.* remarks made by the OSC Chairman, (1981) 2 *O.S.C.B.* 262A, p. 266A (Nov. 27); see *infra*, #71.

by an offeror making a takeover bid for their securities[215]. Any collateral agreement, which would provide a different consideration to certain holders of the same class of securities, is prohibited.

67. The OSC has become very sensitive to transactions whereby voting stock is acquired through agreements followed by a takeover bid where remaining security holders are offered a different consideration[216]. In the opinion of the Commission, such a method of achieving transactions goes against the intent of Part XIX of the *1978 Act*, especially s. 91(3)[217]. To deal with this situation, or put differently, to ensure a complete equality of treatment between majority and minority[218], the OSC issued late in April 1981 an *Addendum*[219] to the Ontario Draft Policy 3-37[220].

68. The *Addendum* does not consider cases where a follow-up offer is required because equality of treatment is respected. However, the OSC is concerned with such equality where a private agreement is not a takeover bid, or is properly qualified under s. 88(2)(c), but where a follow-up bid does not have to be made[221]. The Commission's concern lies with the consideration paid in a subsequent takeover bid, this often being inferior to the amount paid through the private agreement. The *Addendum* issued by the OSC has far-reaching consequences. The Commission will look at the whole scheme, including both the private agreement as well as the takeover bid, to determine whether the same consideration has been offered to every holder of the same class of securities for the purpose of s. 91(3). Such determination will apply when the purchaser has concluded a private agreement with the intention of making a subsequent takeover bid. Moreover, such an intention is deemed existing where a takeover bid is announced within 180 days of the

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215. *1978 Act, supra*, note 1, s. 91(3).

216. See *Control Block Transactions, supra*, note 90, p. IV–110; see *infra*, #72.

217. See *July 17 Notice, supra*, note 207, p. 20A. They have been considered as being takeover bids by the OSC; see J. WILLOUGHBY, "Private soliciting by Wood Gundy termed takeover", *The Globe and Mail*, July 3, 1981, B-2 [citing OSC's Chairman]. See also *Addendum, infra*, note 219, p. 24E. In *Control Block Transactions, supra*, note 90, p. IV–110, the author also proposed that such a way to achieve transactions would be an infringement of s. 89(1)(l), 91(3) and 94.

218. See *infra*, #146; see also *McLaughlin, supra*, note 3, pp. 112C-113C; pp. 59–61; *Torstar, supra*, note 8, pp. 67C-68C.

219. *Addendum to Draft Ontario Policy No. 3-37*, (1981) 1 *O.S.C.B.* 24E (April 24) [hereinafter referred to as *Addendum*].

220. *Draft Ontario Policy 3-37*, (1981) 1 *O.S.C.B.* 7E (Feb. 13) [hereinafter referred to as *Draft Policy 3-37*]. It is a consolidation of *Ontario Policy No. 3-37, Interim O.S.C. Policy 3-51 and 3-52*. In general, this new policy is designed to ensure that security holders are treated in a fair and even handed manner when certain types of combinations or business reorganizations occur.

221. *Addendum, supra*, note 219, p. 24E.

date of the private agreement. The presumption applies *prima facie* and is rebuttable upon an application under s. 99[222].

Where the takeover bid is related or linked to an offer to purchase all securities of a class of any holder pursuant to a private agreement, such linked or related takeover has to be made for all securities of the class sought at a price at least as great as the one paid in the agreement[223].

69. One of the results of the *Addendum* is that two separate transactions are deemed to be only one transaction completed in two steps. The private agreement is viewed as an attempt to avoid treating each security holder of the same class equally where the purchaser seeks effective or absolute control[224]. A subsequent takeover bid made at a smaller consideration is then seen as a breach of s. 91(3). The question is therefore to know whether s. 91(3) has to be considered and applied[225], bearing in mind that a private agreement under s. 88(2)(c) is a takeover bid exempted from all the requirements of Part XIX of the *1978 Act*, except s. 91(1).

70. S. 91(1) is designed to force a purchaser to make a follow-up offer to the remaining security holders where s. 88(2)(c) has been properly relied upon. This offer, the only requirement which has to be observed by the purchaser, is deemed a takeover bid for purposes of Part XIX. The offer has to comply with this Part, except for the provision related to the consideration offered, because s. 91(1) contains specific requirements about this. A certain form of equality of treatment is therefore available to the remaining security holders[226]. The fact of making a takeover bid subsequent to or related to a private agreement, where such a bid is not legally required, cannot be a method of avoiding compliance with the principle of equality of treatment for all holders[227].

A private agreement is an exempted takeover bid subject to s. 91(1) and not to s. 91(3). The bid which has to respect s. 91(3) is not the private agreement, but rather the subsequent or related takeover bid made at a lower price. The consideration offered must be *at least as great* in respect of a related takeover bid and *the same* for a subsequent one[228]. The wording implies that the consideration paid in the first takeover, the private agreement, is higher. The second bid has therefore to be made either at the

222. *Id.*, p. 25E; see *supra*, note 30 for U.S. law.
223. *Id.*, p. 24E; see *infra*, # 71.
224. See *supra*, introduction.
225. See *Control Block Transactions*, *supra*, note 90, p. IV-110, 111.
226. About the consideration, s. 91(3) says that it must be the *same*, while s. 91(1) says that a consideration *equal in value* is sufficient. See *infra*, # 107 and ff.
227. See *infra*, # 97.
228. See *infra*, # 107 and ff.

same or at a consideration at least as great as that offered in the first bid. The *Addendum* stresses that two takeover bids are launched for the same purpose and belong to the same transaction; one bid is exempted and the other one is not exempted from Part XIX. Allowing the second bid not to have a consideration identical to or as great as the one paid in the first bid would constitute a breach of s. 91(3). However, it would be impossible to increase the price paid in the private agreement if the consideration of the second bid is higher, because the introductory language of s. 88(2) submits the private agreement of s. 88(2)(c) only to s. 91(1) and not to s. 91(3). Indeed, the *Addendum* submits only the second bid to s. 91(3) and not the first one, the *Addendum* being based upon the premise that the consideration paid in reliance on s. 88(2)(c) is higher than the one offered in the second bid, and that the private agreement has been entered into prior to the takeover bid.

71. To cover this latter situation, the OSC has recently decided to rely upon s. 89(3) in order to challenge private agreements entered into at a consideration greater than the one offered in a takeover bid. This reliance upon s. 89(3) has emerged from the lengthly battle for the control of Canada Permanent; the Commission is taking the view that both offers are linked or integrally related to one another, thereby infringing upon s. 89(3)[229].

72. During the course of the same takeover bid[230], the Commission faced a new situation where private agreements were used simultaneously to a public takeover circular. The Commission has responded to this practice with orders pursuant to s. 124[231] denying the availability of s. 88(2)(c) to the offeror, and cease trading orders[232]. It has also ruled that these agreements ought to be viewed as takeover bids[233], and that such a procedure was against the spirit of the *1978 Act*. The OSC has also decided that these agreements could not be said as being market purchases[234].

73. The stock exchange purchases have not been prohibited so far. Early in April 1981, the Commission refused to express comments on the offerors' rights to purchase on the floors of stock exchanges while making

229. See Notice of Hearing *In the Matter of Genstar Corporation*, (1981) 2 *O.S.C.B.* 62A (Oct. 16). No decision has yet been reached.

230. See also *supra*, #55.

231. See *supra*, note 184; *Genstar Corp. and Canada Permanent Mortgage Corp.*, (1981) 2 *O.S.C.B.* 37B (July 17). This order was subsequently rescinded; see *July 17 Notice, supra*, note 207, p. 19A.

232. See *e.g. Penn West Petroleum Ltd. Strom Resources Ltd*, (1981) 2 *O.S.C.B.* 21D (July 17), rescinded (1981) 2 *O.S.C.B.* 80B (Aug. 7).

233. *Supra*, note 217.

234. *July 17 Notice, supra*, note 207, p. 20A.

takeover bids[235]. It refused however the right to purchase through the private market[236].

74. It is obvious that the actual market situation has a distortive effect upon the use of private agreements. The problem is no longer whether a corporation's asset is sold, entitling all security holders to share its value and being offered an equal opportunity. It is rather to determine whether every security holder, either majority or minority, is given an equal treatment in takeover bid situations[237].

That "evolution" of the use of the private agreement exemption and the increasing involvment of the Commission raise more substantial questions on a long term basis. That s. 88(2)(c) had been used first by sophisticated investors, then as a device to sell control at a premium and now as collateral manœuvres to succeed in takeover fights is *per se* somewhat irrelevant. On the other hand, the OSC's involvment may be justified by the necessity to protect both the Ontario market credibility and minority shareholders, two objectives of the *1978 Act*[238]. The true question is to determine the extent to which market participants are willing to be regulated[239]; in other words, is the concept of equality of treatment still fully applicable and desirable in the North American marketplace?

### 3.2. The follow-up offer

#### 3.2.1. Prerequisite conditions of application

##### 3.2.1.1. Private agreement

75. Where a takeover bid is exempted from Part XIX of the *1978 Act*, because it falls within the private agreement exemption, the purchaser is subject to the provisions of s. 91(1) if the conditions of application are met. This will happen if there is a published market for the securities bought through a private agreement, and if the price paid exceeds 15% of the average price listed on this published market. The follow-up offer will have

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235. See *July 17 Notice, supra*, note 207, where it was stressed that these purchases have to be made through a stock exchange or at the OTC market.

236. See *supra*, note 212; see *Control Block Transactions, supra*, note 90, p. IV-112.

237. See *e.g. infra*, #86.

238. See for a powerful example, *Turbo case* [reasons], *supra*, note 212, 82C.

239. So far, the Commission has clearly stated that its involvement in takeovers ought not to imply either a violation of the law and the policies or criticism of the conduct of any party. See *e.g. Notice Re: Commission Enquiry — Take-over Bid Legislation and Policy. Proposed Take-Over Bid for Noranda Mines Ltd*, (1981) 2 *O.S.C.B.* 22A (July 24).

to be made within 180 days of the date of the agreement, at a consideration equivalent to the greatest one paid in the agreement[240].

76. As was suggested above, it might be possible to conclude a sale by way of agreement which does not fall within s. 88(2)(c). In such a case, two options face the purchaser. In the first, no takeover bid is made, thereby preventing s. 88(2)(c) from coming into play. In such an instance, there are no consequences for the purchaser because the Ontario legislation does not apply to this private agreement transaction[241].

In the second instance however, there is a takeover bid as defined by s. 88(1)(k), but the conditions of s. 88(2)(c) have not been fulfilled. The result in this case is completely different *vis-à-vis* the purchaser. Because he has made a takeover bid which does not comply with the requirements of the *1978 Act*, he contravenes the *Act* and is guilty of an offence under s. 118(1). Moreover, those security holders acting as sellers have a right of rescission against the purchaser, and every other security holder to whom a takeover bid circular should have been communicated has a right to claim damages[242].

### 3.2.1.2. The published market

77. Where s. 88(2)(c) has been properly relied upon, another condition must be satisfied before a follow-up offer is required; there must be a *published market* for the class of securities acquired through the private agreement[243]. This expression is defined in s. 88(1)(j) and refers to a stock exchange recognized by the OSC on which the offeree company's securities are listed, or any other market on which such securities are traded, providing that the trading prices are published in a newspaper or a business publication. In its *Policy 3-42*[244], the Commission recognized the Toronto Stock Exchange (TSE) for the purposes of s. 88(1)(j). In this *Policy*, the OSC also emphasized that the TSE would not be the only exchange qualified as being a published market. The second part of the definition implies that almost any established stock exchange in Canada or elsewhere would be considered an acceptable published market[245].

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240. S. 91(1) may also become compulsory if an offeror, without being legally bound to do so, undertakes to make an equivalent offer to remaining security holders. See *infra*, # 107 and ff.

241. See ALBOINI, *supra*, note 4, p. 723.

242. *1978 Act, supra*, note 1, s. 130; see *Control Block Transactions, supra*, note 90, p. IV-97.

243. See *In the Matter of Sands Oil & Gas Exploration Limited*, (1981) 2 *O.S.C.B.* 188B (Oct. 16) where no published market existed; an exemption under s. 99(e) from s. 91(1) was granted.

244. Ontario Policy No. 3-42, *Recognition of Stock Exchanges*, (1979) *O.S.C. Weekly Summary*, (Sept. 14), 183, revised in March 1981.

245. *Id.*, p. 185.

### 3.2.1.3. The market price

78. The meaning of *market price*, as well as its calculation, are the core of s. 91(1). Generally speaking, a follow-up offer will be mandatory where the consideration paid for the securities sold through the private agreement is 15% or more above such market price.

79. This expression is defined in s. 88(1)(e) and refers to two alternative methods: (1) the opportunity for the Commission to determine what the market price of the securities is, in accordance with s. 99(b); or (2) where such a determination has not been made, the market price is calculated according to the *Regulation*. In both cases, the market price refers to the published market of the class of securities acquired by private agreement.

#### 3.2.1.3.1. The method under the Regulation

80. The method of calculating the market price under the *Regulation* is found in s. 163; it is defined as being 15% in excess of the simple average of the closing price of the securities exchanged during each of the ten business days preceding the date of the first agreement[246]. The day on which the agreement is to take place should not be included in calculating the ten days[247]. The computation is conducted for the class of securities acquired through the private agreement. The closing price is determined daily by reference to the type of published market of the class of securities bought. Where there is more than one published market, but only one within Canada, the closing price is the price per security of the last trade effected on the Canadian published market. Odd and block transactions are excluded from the calculation. In the event that only excluded transactions were conducted, the closing price would simply be an average of the bid and ask prices[248].

81. This last part of s. 163 has been given an extended meaning by the OSC in the *Newsco*[249] case. In the calculation presented by the applicant, transactions occurred during only six of the ten days required. The average was then calculated by reference to this number, the effect being an increase of the market price and a decrease of the premium resulting from the sale. It does not seem that any excluded transactions were concluded during the four

246. *Regulation*, s. 163(3).

247. See *Control Block Transactions, supra*, note 90, p. IV-98.

248. *Regulation*, s. 163(1) and (2).

249. *In the Matter of Ronalds-Federated Ltd and In the Matter of Newsco Investments Ltd*, (1980) *O.S.C. Bulletin*, 304 (July 1980) [hereinafter referred to as *Newsco*]. See *infra*, # 130 for the facts on the case.

days left aside. The Commission did not accept this method of calculation. It said that s. 163(1) should have been applied, using the bid and ask prices published by the TSE to determine the closing price[250].

82. When there is more than one Canadian published market, the relevant one will be selected on the basis of the greatest volume of trading in the particular class of securities acquired through the private agreement for the ten business days preceding the date thereof. The same pattern will be used when selecting an appropriate market located in a foreign jurisdiction. There is nothing to suggest what happens if there is no Canadian but several foreign published markets. The use of the trading volume should however address this difficulty. Finally, a published market is deemed non-existing where no closing price may be calculated for at least one of the ten business days.

### 3.2.1.3.2. The method under the Commission's discretion

83. The other method which may be used to determine the market price is to seek a ruling from the Commission based upon s. 99(b). This section gives the OSC the power to set aside the calculation made in accordance with the *Regulation* and to substitute its own finding. Such a determination may only be made where the market price has been affected by an anticipated takeover bid or by improper manipulation. Indeed, specific rumours and activities, organized by either the purchaser or the seller, may result in an increase of the market price over a short length of time, thereby decreasing the premium received and eventually setting aside the follow-up obligation originally required[251]. The pressure created by an anticipated takeover may also push the value of the securities up or down, thereby producing a price which is not representative of the "[...] true trading prices of such securities"[252]. Section 99(b) is designed to provide a remedy to such situations.

84. The section might be classified within the category of the anti-avoidance rules of the follow-up offer. In fact, the purpose of s. 99(b) is emphasized by the eventuality that security holders might be intentionally deprived from the premium to which they are entitled following either questionable practices from the purchaser or unrealistic market situations[253].

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250. *Id.*, p. 307.

251. *Control Block Transactions, supra*, note 90, p. IV-99 and IV-107. A good example of a similar situation during the course of a takeover fight is found in a Notice released by the OSC in September 1981 and again in February 1982. See *Take-Over Bids: Security Exchange Offers Market "Support", "Maintenance" or "Stabilization"*. (1981) 2 *O.S.C.B.* 48A (Sept. 25); (1982) 3 *O.S.C.B.* 64A (Feb. 5).

252. *BCFP-Noranda-AEC(1), supra*, note 15, p. 119C.

253. *Id.*, p. 120C.

85. Section 99(b) allows the Commission to exercise its discretion only if certain criteria are established. It must be satisfied that a takeover bid was anticipated, and, if so, whether such an anticipation affected the market price of the securities sold by private agreement [254]. Where these two findings are positive, the OSC may determine, "[...] if it chooses to do so" [255], a new market price.

86. The OSC decision in the *BCFP-Noranda-AEC(1)* case gives the impression that the Commission will act very cautiously where requested to exercise its discretionary power under s. 99(b). In its first decision under s. 99(b), the Commission emphasized the fact that it should not "[...] abuse the rights of majority security holders" [256]. Applied specifically to the case decided, the OSC noted that such security holders should not be deprived from the opportunity to sell their control block without the purchaser being obliged to make a follow-up offer simply "[...] because the market players anticipated a second take-over bid [...] or a follow-up bid by the offeror, with no evidence upon which such anticipation could reasonably be based" [257].

The Commission went further and linked the exercise of its discretion on the existence and reliance by investors upon a *bona fide* trading price. It said that cautiousness will be exercised in calculating a market price different from the one arrived at under s. 163 of the *Regulation* where the "[...] published market prices reflect the auction market's perception of the actual exchange market value of the subject security" [258]. Using the same concept, the Commission further said it would be improper to compel a purchaser to make a follow-up offer where the *bona fide* market relied upon is subsequently viewed as having been "substantially affected" [259] by tradings whose object was to trigger the application of s. 91(1). In other words, the OSC is not only attempting to prevent majority security holders from using artificial schemes to avoid s. 91(1), but as well to prohibit minority security holders from devising similar schemes to obtain a mandatory follow-up offer [260].

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254. The same pattern also applies with respect to improper manipulation.
255. *BCFP-Noranda-AEC(1), supra*, note 15, p. 118C.
256. *Id.*, p. 120C.
257. *Ibid.*; see also *BCFP-Noranda-AEC(2), infra*, note 441, p. 16C.
258. *BCFP-Noranda-AEC(1), supra*, note 15, p. 120C.
259. *Id.*, p. 121C. The Commission stressed in the prior paragraph that "[t]here must be confidence in the marketplace for holders of large blocks of securities as well as for holders of small blocks of securities". Page 120C.
260. See also *BCFP-Noranda-AEC(2), infra*, note 441, pp. 14C-15C. The actual Chairman has compared those cases to "consumerism-type litigation" launched by "Nader-like people". See (1981) 2 *O.S.C.B.* 262A, p. 266A (Nov. 27).

87. In the *BCFP-Noranda-AEC(1)* case, s. 99(b) was used to challenge[261] the deal concluded by Noranda Mines Ltd with Alberta Energy Co. Ltd, whereby Noranda sold to AEC its 28% holding in British Columbia Forest Products. In late March 1981, Noranda made a takeover bid to acquire MacMillan Bloedel. In a response to a letter from the British Columbia Minister of Forests, Noranda announced early in April a willingness to sell its interest in BCFP. On April 25, Noranda agreed to sell its holding to AEC by way of private agreement in consideration of $25 a share, but the information that a deal had been reached was not released until May 15. Because the consideration paid was not in excess of the market price, the OSC first ruled that AEC would not have to comply with s. 91(1)[262].

An application was then filed by Cemp Investments Ltd and several other security holders under s. 99(b), asking the Commission to determine a new market price for the shares of BCFP for the reason that such shares had been affected by an anticipated takeover bid[263]. The applicants were obviously attempting to compel AEC to make them a follow-up offer. Such an offer was at that time impossible since no "excess premium"[264] had been paid. If they were able to lower the stock exchange price, then the market price would decrease and the premium paid would correspondingly increase. The 15% premium allowed would therefore no longer be respected, bringing into play s. 91(1).

88. The result of the decision is that a new market price will not automatically be calculated by the Commission where it has been established that an anticipated takeover bid had affected the market price of the securities sold by private agreement. In the *BCFP-Noranda-AEC(1)* case, the evidence submitted was very technical; evidence from financial analysts as well as a substantial amount of financial data were presented to the OSC. However, the determination of a new market price will be made with respect to the two tests laid down by the Commission: the need not to abuse the majority's rights and the existence and reliance by investors on a *bona fide* trading market.

89. The first test may be viewed as a test of general application which might serve as a guideline where the OSC exercises its discretion under any subsection of s. 99. The fact that the statement was made in relation to the Commission's responsibility and duty seems a clear indication that the OSC does not intend to restrict its application only to s. 99(b). Phrased differently,

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261. It was also used before as reported in *Control Block Transactions, supra*, note 90, p. IV-108; see also *BCFP-Noranda-AEC(2), infra*, note 441, pp. 8C to 11C.
262. See *The Globe and Mail*, May 22, 1981, B-7.
263. *Id.*, May 23, B-20.
264. See *infra*, note 271.

the test might be viewed as a measure of safety for a *bona fide* purchaser concluding a transaction under s. 88(2)(c) where the public price is distorted by the effect of the actual "takeover fever". In fact the test could be viewed as independent from the second one, and might be applied even though the reliance on a *bona fide* trading market is not properly established or is doubtful.

90. The second test is based on the investor's reliance upon a *bona fide* trading market: it brings into play the need to determine the parties' intention. Highly subjective, the test gives the Commission the difficult duty "[...] to look at the intention of the parties and [...] to ascertain what parties do knowingly" [265]. As noted by the OSC, this difficulty should not prevent the Commission from attempting to protect the interests of both majority and minority security holders [266]. These two tests do not narrow the availability of s. 99(b), but rather restrict the chance of a ruling modifying the market price established under s. 163 of the *Regulation.*

### 3.2.1.3.3. Other elements of the market price

91. In the calculation, reasonable brokerage fees or other commissions can be added to the market price. The OSC noted in *Newsco* that where none of these fees were paid as part of the private agreement, no such amount should be added to the market price. What had been done by Newsco was to add the maximum commission applicable on a retail trade to the market price, thereby increasing it. Counsel for the TSE pointed this out, and the Commission agreed that such a calculation was improper [267]. One commissioner disagreed on the point, saying that such was not a determining factor as to the application of s. 91(1). Relying upon the company's computation of the market price, he said the point was not vital nor was the Commission required to express an opinion on the meaning of the statutory language [268].

92. Once the market price has been properly calculated, then the consideration paid by the purchaser has to be determined. Where the offer has been made in cash, in Canadian currency, the result is automatic. However, where the sum was paid both in cash and in securities, conversion

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265. *BCFP-Noranda-AEC(1), supra*, note 15, p. 121C.

266. *Ibid.*

267. *Newsco, supra*, note 249, pp. 307-08.

268. *Id.*, p. 316. He added that

> [...] [h]ad the point been significant I would have held that because a price paid in a market transaction ordinarily would have been increased by a brokerage fee or commission it was the intent of the statute that the statutory market price was to be calculated on the same basis.

ratios as well as the exchange rate of a foreign currency will be used if required[269]. The result will be an amount in Canadian dollars.

93. As soon as the consideration paid exceeds the market price, a follow-up offer is mandatory. In fact, the meaning of market price itself allows a 15% premium above the price listed on a published market. Such "allowable control block premium"[270] must be distinguished from the "excess premium"[271], which is any amount above the one allowed. The result is unequivocal[272]: "an excessive premium, however, small, require[s] [the applicant] to make a follow-up offer to the remaining shareholders [...] or to seek an exemption"[273].

This point is crucial. The amount of the excess premium is irrelevant when considering whether or not the purchaser has to make a follow-up offer. In *Newsco*, the excess premium was worth $0.78 and in *Atco*, $1.96. These amounts, regardless of how small they were, brought into play the follow-up requirement[274]. The fact that such a result may appear extreme on some occasions[275] is also irrelevant; what triggers the follow-up offer is not the consequences thereof, but rather whether the prerequisite conditions are fulfilled.

94. The *Interim Report* put forth an interesting suggestion as to the concept of allowable control premium and the excess one by proposing that the consideration paid in the follow-up offer be limited to that excess premium. As they explained,

> [t]his would recognize, in effect, that a 15% premium was acceptable and non-abusive of the interests of minority shareholders, and that a sharing of the premium was necessary only to the extent that the premium exceeded the amount which the legislation permitted.[276]

269. See for an example *Atco, supra*, note 158, p. 418.
270. *Newsco, supra*, note 249, p. 307.
271. *Ibid.*
272. *McLaughlin, supra*, note 3, p. 112C; pp. 59-60.
273. *Newsco, supra*, note 249, p. 308. *See infra*, #ch. 4.
274. See *Newsco, supra*, note 249, p. 311 and *Atco, supra*, note 158, pp. 419-20.
275. In the case of Newsco, an excess premium worth $0.78 forced the company to spend $18 millions for the follow-up offer. The Commission was however very sensitive and cautious about the consequences of a follow-up offer. It said that such a result (for Newsco)

> is quite true, but it only illustrates that a general Policy Statement such as 3-41, and a definition of market price such as is attempted by s. 162(3) of the Regulations, cannot cover all possible situations. Experience may dictate that amendments to the Act, the regulations and the Policy Statement will be necessary to take account of the realities of the marketplace and to insure that equity is done as between shareholders. In accordance with the Commission's practice, before any such changes are made they will be exposed for public comment and discussion.

*Newsco, supra*, note 249, pp. 314-15.

276. *Interim Report, supra*, note 16, p. 236A.

The suggestion respects the spirit of the *1978 Act* and gives more flexibility to the purchaser while recognizing that the control block has a specific value which may lawfully belong to the seller so long as it stays within a reasonable amount. It cannot be said that equality of treatment between shareholders is not respected since the *1978 Act* already permits a reasonable premium. The suggestion put forward by the *Interim Report* simply attempts to case the administration of s. 91(1)[277].

### 3.2.2. Conditions of application

95. Where the conditions found in both s. 88(2)(c) and s. 91(1) are met, a follow-up offer to the remaining security holders has to be made within 180 days of the date of the first agreement[278]. As the Commission noted,

> [...] a follow-up offer is required *only* if there is a published market in the class of securities acquired and the value of the consideration paid for any such securities exceeds the defined market price at the date of the relevant agreement plus reasonable brokerage fees.[279]

96. This statement seems to imply that the follow-up offer is required only where all the conditions discussed above are satisfied; *Policy 3-41*[280] reinforces this view[281]. One difficulty comes from the fact that the *Policy* also states that a follow-up offer is expected even though "[...] some or all of the conditions triggering the obligation in section 91(1) are not present"[282]. Moreover the OSC, paraphrasing the same section of the *Policy*, said that the starting point for making a follow-up offer is an expectation, and if s. 91(1) is applicable, a legal requirement[283]. Both statements were made in the context of the accepted bias in good commercial practices which favors making such an offer.

This possible interpretation is unlikely[284], having regard to the actual state of the law in Ontario. It is further doubtful that a moral bias would be sufficient to impose upon the purchaser of control such a general offer. The forcefulness with which people are seeking an exemption from s. 91(1) is

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277. This suggestion will unlikely be retained having regard to the actual interpretation given to s. 91(1) by the OSC.
278. It must be stressed that the offer must be made by the Offeror. Unless an exemption is granted under s. 99(e), a subsidiary or another company could not be substituted to the Offeror to comply with s. 91(1). See *Turbo case* [reasons] *supra*, note 212, p. 79C.
279. *Newsco, supra*, note 249, p. 306; see also *Atco, supra*, note 158, p. 417. Emphasis added.
280. See *infra*, note 345.
281. *Id.*, p. 177.
282. *Ibid.*
283. *Newsco, supra*, note 249, pp. 311-12, repeated in *Atco, supra*, note 158, p. 420.
284. See *infra*, # 130 to 133.

indicative of the purchaser's reluctance to extend the private offer to every security holder. Furthermore, in all the decisions released dealing with s. 91(1), the Commission has carefully established that all the threshold tests found in s. 91(1) were satisfied before compelling the purchaser to make a follow-up bid. The statement found in *Policy 3-41* may be indicative of the direction in which the OSC would like to see the purchaser's behavior move, but is merely an indication of such a desire, not a legal requirement.

97. Notwithstanding this interpretation, a follow-up offer may also become compulsory even though the legal obligation to do so might have been non existant. This is indeed what happened in the *Turbo case*, where Turbo undertook to make a general offer to the minority shareholders of Merland. Even though the OSC decided that a takeover bid had been implemented, it said that the provisions of the *Act* were applicable to the offer made by Turbo whether its obligation arose from the *Act* or from its voluntary commitment [285]. In other words, a purchaser of control who agrees to make a follow-up offer on a voluntary basis must strictly comply with the legal requirements applicable.

This position has far-reaching consequences. The flexibility which might have been gained from an undertaking to respect s. 91(1) seems to disappear. It is now probably easier for a purchaser to wait until being ordered to make a follow-up offer rather than attempting to respect a legislative spirit with which he likely disagrees. In any event, it seems that s. 91(1) is becoming the section to avoid [286]. This situation appears to result from an attempt to apply a certain philosophy to a reluctant marketplace through a legislation which everyone thought was not going to be strictly enforced.

### 3.2.2.1. Within 180 days

98. As stated above, the follow-up offer must be made within 180 days of the date of the first agreement. Such an offer being deemed a takeover bid, the requirements of the *1978 Act* must therefore be followed [287].

99. However, a ruling sought under s. 99(e) might prevent the offeror from being caught by the timing rule. The facts of each individual case will likely exercise a strong influence as to whether the ruling is considered not prejudicial to the public interest. Among these facts, the diligence of the applicant will be heavily relied upon. In the *Turbo case* for instance, the Commission issued an offer extending from December 29, 1981 to February

285. *Turbo case* [reasons], *supra*, note 212, p. 86C.
286. See *infra*, # 141.
287. *1978 Act, supra*, note 1, s. 91(1) *in fine*.

26, 1982 the follow-up offer Turbo Resources had undertaken to complete several months before[288]. Turbo represented to the OSC that it had experienced delays in completing evaluations of both Merland and Turbo shares and that other reasons beyond its control had hampered the Turbo follow-up offer. It is worth noting that the proposed federal budget tabled on November 12, 1981, high interest rates and equity market prices were some of the events relied upon by Turbo in seeking the ruling[289].

100. Another method of postponing the follow-up offer is to seek an exemption pursuant to either s. 99(a) or (e). Furthermore, if the exemption is denied, the follow-up offer shall still be made within the time allowed[290]. Quasi-criminal sanctions, civil actions, either by offerees or the OSC[291] may otherwise be launched against the purchaser.

The time at which the exemption must be presented is an important feature. In *McLaughlin* for instance[292], the exemption was submitted on March 6, 1981, exactly nine days before the expiration of the 180 days period[293], while the hearing took place on April 14. The initial agreement was concluded on September 16, 1980. Relying upon the wording of s. 99(a), counsel argued that the Commission could not issue an order pursuant to s. 99(a) in favor of the applicant where the time allowed to make the follow-up offer had expired[294]. They also relied upon the OSC policy of not granting applications having a retroactive effect[295], underlying that a positive ruling in favor of McLaughlin would have the effect of retroactively curing the applicant's default[296].

288. *A Follow-up Offer by Turbo Resources Limited to Security Holders of Merland Explorations Limited*, (1982) 3 *O.S.C.B.* 14B (Jan. 15), varied and exented until March 5, 1982, by an order pursuant to s. 140: *In the Matter of a Take-Over Bid by Bankeno Mines Limited for Securities of Merland Explorations Limited*, (1982) 3 *O.S.C.B.* 164B (Feb. 26).

289. See (1982) 3 *O.S.C.B.* 14B, p. 15B (Jan. 15).

290. *Newsco, supra*, note 249, p. 314.

291. See *infra*, #101, #103 and #104.

292. *Memorandum to the Commission*, April 6, 1981, released April 14, 1981 at the hearing [hereinafter referred to as *Staff submissions*].

293. The reasons for such a delay were explained at the hearing by counsel for McLaughlin, and were due to reasons beyond the control of the applicant. However, the *staff submissions* stressed the fact that

> [...] McLaughlin placed himself and the Commission in a position where it was not feasible for the matter to be dealt with in the normal course prior to March 15.
> [...] Even if the application could have been considered and decided on March 6, if it were refused, McLaughlin would have had only nine days to comply with subsection 91(1) by making a follow-up offer. This would have been physically impossible, especially since compliance with (or exemption from) the additional requirements of O.S.C. Policy 3-37 would have been necessary.

See *Staff submissions, supra*, note 292, pp. 6-7.

294. *Id.*, pp. 5-6.

295. *Id.*, p. 6.

296. *Id.*, p. 7.

Despite the fact that such an argument was made in relation to s. 99(a), it may possibly be made under s. 99(e) as well. Therefore, an application seeking an extension of time or an exemption would have to be presented before the expiration of the period allowed to comply with s. 91(1)[297]. A request made subsequently to such an expiration would likely be denied, according to the staff counsel's argumentation in *McLaughlin.*

101. Such an application brings into play s. 129 of the *1978 Act* which provides the remaining security holders with a civil right of action where an offeror: (1) does not make a follow-up offer; (2) makes one, but with a consideration different in value from the greatest one offered in the private agreement; or (3) refuses to take up the securities deposited pursuant to such an offer[298]. The section gives them the right to receive the benefit of the greatest financial offer made in the private agreement. Where the consideration is not equal in value, they are entitled to receive the difference between the two amounts. In both offers, damages may be assessed if they can be established. Section 135 stipulates the time within which the action may be brought: not more than 180 days after the plaintiff first acquires knowledge of the offeror's breach, or three years after the date of the breach, whichever is earlier. Where no offer is made, the right of action is available only where the 180 days period has not been respected.

102. The question to solve starts from the premise that a positive ruling has been released. Where an extension of time is sought, a positive ruling would prohibit any action based upon s. 129 for the reason that the 180 days period has not yet expired[299]. On the other hand, an order based either upon s. 99(a) or (e) exempting the purchaser from s. 91(1) once the time limit is expired would also prohibit security holders from using s. 129 since an exemption from the follow-up offer requirement has been granted. The application of s. 129 is conditional upon a finding that s. 91(1) has not been respected.

The same considerations are pertinent where an action under s. 129 is started before an appropriate ruling has been issued by the OSC. In this case, a positive ruling will obviously have a retroactive effect nullifying the right of action under s. 129. The remaining security holders will therefore lose on both sides. On the other hand, a negative decision will leave two choices: to accept and wait for the follow-up bid or to waive such a right and continue the legal action launched under s. 129. These options seem mutually exclusive. However, it must be noted that the remaining security holders are

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297. See *e.g. Turbo case*, [reasons] *supra*, note 212 and *supra*, note 288.
298. *1978 Act, supra*, note 1, s. 129; see *Alboini, supra*, note 4, p. 728.
299. But not the right to receive the follow-up. See *supra*, note 288, p. 15B.

not disadvantaged by such an interpretation. If they wait for the follow-up bid, they will be paid the same amount as they would have received under s. 129, with the exception of damages. However, these damages could likely be nominal, especially where the length of time between the end of the 180 days and the OSC ruling is brief. Bearing in mind the time, energy and specifically the legal costs which must be incurred in seeking a court ruling on the obligation, it would be more appropriate and faster for them to waive their rights under s. 129 and to accept the offer made by the purchaser. The Commission should be sensitive to these costs involved and not be reluctant to issue a negative ruling solely because a legal action has been started by some security holders.

103. Besides s. 129, the OSC may force a purchaser of control to comply with s. 91(1) by obtaining an order for compliance under s. 122(1). So far, the Commission has used s. 122(1) in *McLaughlin* [300] and intends to in the *Turbo case* [301]. In a decision released late in December, the Supreme Court of Ontario granted the request compelling McLaughlin to proceed with the follow-up offer.

104. The judge made interesting comments during the course of his decision. Saying that Mr. McLaughlin had declared in an affidavit his incapacity to pay the offer, he added that he was not

> prepared to refuse the order on the hypothetical possibility that he [McLaughlin] will not be able to pay for every outstanding place and when it is not known how many shareholders will accept the offer and what assets McLaughlin has to meet these acceptances.[302]

Had McLaughlin been financially unable to pay, it seems that the Court would have denied the OSC request. This raises the question as to whether s. 91(1) should not be enforced because of its adverse effect upon the purchaser. It is submitted again that, in the actual state of the law, the impact of a follow-up offer is irrelevant and should not be taken into consideration to decide whether the purchaser must proceed with the offer. Once the prerequisite conditions of application are fulfilled, s. 91(1) is mandatory. Furthermore, if s. 91(1) is not respected, the late purchaser may be guilty of an offence under s. 118 [303] of the *Act*. Such liability may probably coexist with a civil action pursuant to s. 129 or may be started as soon as the follow-up obligation has been infringed upon. The fact that the follow-up bid will be made later, to comply with an OSC decision, should not be accepted as a defence to an action under s. 118; the offence is in the breach of s. 91(1) and its timing.

300. (1982) 3 *O.S.C.B.* C-1 (Jan. 8).
301. *Turbo case*, [decision] *supra*, note 212, 57C, p. 64C (March 12).
302. *Supra*, note 300, pp. C-6, C-7.
303. *1978 Act, supra*, note 1, s. 118(c) or (d).

### 3.2.2.2. To security holders in Ontario or in a uniform act province

105. The follow-up offer must be made in respect of all the additional securities of the same class owned by security holders living either in Ontario or in a *uniform act province*. This latter expression is defined in s. 88(1)(l), and is understood as being a province or territory, designated by *Regulation*, where legislation contains provisions "substantially the same" both as the Ontario takeover bid section and s. 129. Although it is expected that the four western provinces and Québec will fall within the definition[304], such a regulation determining *uniform act province* has not yet been issued.

106. The inclusion of non-Ontario security holders to whom a follow-up bid is offered has been seen as demonstrating "[...] the difficulties inherent in any attempt to develop a national regulatory scheme through uniform provincial legislation"[305]. The authors of the federal *Proposals* noted that such an offer would have been ineffective where made only to Ontario security holders. They also stressed that the expression *uniform act province* was an "unsatisfactory halfway measure"[306] because minority security holders not living in such a province would still be excluded from the follow-up bid required. An offer to all security holders resident in Canada was therefore suggested as a preferable alternative. Finally, questions were raised respecting the constitutional aspects of the takeover bid section of the *1978 Act*. The takeover bid definition, unrestricted to the province of Ontario (as well as the follow-up offer deemed a takeover bid), was seen as an attempt to regulate interprovincial transactions, being thereby beyond the scope of provincial jurisdiction[307]. The forcefulness of such an argument must however be assessed by reference to the actual interpretation given to the different securities legislation in Canada, as acknowledged by the authors of the *Proposals*[308]. So far, it does not seem that constitutional grounds have been used to oppose the follow-up offer obligation.

### 3.2.2.3. A consideration at least equal in value to the greatest one paid in the agreement

107. The offer made to the remaining security holders must be equal in value to the greatest amount paid at the time the agreement was concluded.

304. *Alboini, supra*, note 4, p. 727.
305. P. ANISMAN, P.W. HOGG, *supra*, note 166, p. 149.
306. *Id.*, p. 150, note 72.
307. *Id.*, note 73.
308. *Id.*, ch. 2, pp. 143–53.

The consideration offered to the two categories of security holders need not be identical[309]: an equality in value is sufficient. This pattern, likely designed to give the offeror more flexibility[310], has so far proven to be the most difficult feature to apply.

At the time the *Act* was enacted, s. 99(c) did not raise substantial questions. Any interested person was given the opportunity to submit an application hereunder; this application likely had to be made before the consideration was tendered[311]. A valuation of the shares was suggested where the offeror was seeking the ruling[312].

108. The takeover fever had however a serious impact upon these initial considerations and drastically increased the involvment of the OSC. An *Addendum* to *Draft Policy 3-37* was released to deal with the type of consideration to be offered in case of concurrent takeover bids and private agreements. A takeover bid made concurrently to an agreement will have to contain a consideration *at least as equal* as the one offered in such an agreement. In case where an agreement is entered into with the intention to make a subsequent takeover bid, and where s. 88(2)(c) does not apply or a follow-up bid is not required, *the same consideration* as that in the agreement has to be offered in the takeover bid[313].

309. *Torstar, supra*, note 8, pp. 64C and 66C.

310. *Alboini, supra*, note 4, p. 728.

311. The timing of an application pursuant to s. 99(c) appeared to be an important factor before the OSC decision in the *Turbo case*. The wording of s. 99(c) implies that an application by the Offeror must be made before the offer is tendered to the remaining security holders. The Commission would likely lose jurisdiction once the offer is made. The situation is a little more troublesome where offerees submit the application. Once the consideration has been tendered to them, it seems that they will not be able to obtain a decision from the Commission because the consideration offered is no longer a proposed consideration to be offered. The Offeree would therefore never be given the opportunity to make an application under s. 99(c), unless the Commission is willing to accept an argument to the effect that the consideration offered remains a "consideration proposed to be offered" in respect of each security holder, until accepted. Even though s. 129 is still available, the remaining security holders would have to bear all of the drawbacks of a civil action. An injunction might however be applied for in an attempt to stop the offer from being completed, or an order to the OSC pursuant to s. 123. See generally *Alboini, supra*, note 4, p. 728. In the course of the bid for Canada Permanent, First City undertook to apply to the OSC pursuant to s. 99(c) at the time where the precise terms of its offer were unknown or undetermined. See (1981) 2 *O.S.C.B.* 85B (Aug. 14). Since the decision in the *Turbo case*, this reasoning seems doubtful.

312. *Alboini, supra*, note 4, p. 728.

313. *Addendum, supra*, note 219, p. 24E; see *supra*, #70. The principle found in s. 91(3), that every security holder has to be treated equally, underlies these two possibilities. See *e.g. Torstar, supra*, note 8, pp. 64C-65C.

An equality of treatment among offerees as well as between offerors and offerees, rather than identical treatment, is the major concept underlying the Commission's attitude. Such

Early in August 1981, the OSC released a notice[314] wherein it stated that it would take into account variations resulting "from the operation of economic factors" between the date of the agreement and the follow-up offer in assessing the value of the consideration offered. At the same time, another notice was issued in which the OSC took the position that it was quite inappropriate

> for any party on behalf of the offeror or in support of the offeror's bid to make purchases in the market in guise of market "support", market "maintenance" or market "stabilization" which have the effect of keeping those market prices at levels higher than would have been the case in absence of such purchases.[315]

It also issued orders pursuant to s. 124 because the proposed consideration did not appear to be at least equal in value to the one offered[316]. The peak of this involvment was reached in the *Turbo case*, the Commission's jurisdiction being this time directly but unsuccessfully challenged[317].

109. In this case, the Commission stated that a non-cash consideration offered to minority shareholders must be expressed in dollars in order to compare its value to the cash consideration paid in the agreement[318]. Having to choose between the net asset value or the market price of the securities proposed as the consideration, the OSC selected the latter to determine this value[319]. Because the units were not traded, it was necessary to establish the market price thereof. The very technical evidence given by four witnesses was based upon a common feature, that the market price,

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an equality, or equivalency, is achieved through different wordings. *The same consideration* must be paid where a takeover bid is launched following a private agreement, or where no such agreement is entered into before. The consideration must be *at least as great as* the one offered in an agreement where a takeover bid is related or linked to such an agreement. The consideration will be *at least equal in value to the greatest one* paid in an agreement where a follow-up offer is made. It is unlikely that the expression *at least as great as* and *at least equal in value to the greatest one* will be interpreted differently despite the difference in wording. The equality of consideration paid where several agreements are concluded is not considered.

See for the interpretation of the same consideration *Torstar, supra*, note 8, pp. 64C-65C; *John Labatt Ltd and Dominion Dairies Ltd*, (1981) 1 *O.S.C.B.* 189B (June 19) [ruling] (1981) 2 *O.S.C.B.* 1C (July 24) [reasons].

314. *Re: Take-Over Bids - Value of Consideration in Follow-up Offers*, (1981) 2 *O.S.C.B.* 23A (Aug. 7).

315. *Take-Over Bids: Security Exchange Offers - Market "Support", "Maintenance" or "Stabilization", supra*, note 251.

316. *In the Matter of the Proposed Amalgamation of Universal Explorations Ltd and the Petrol Oil & Gas Company, Limited*, (1981) 2 *O.S.C.B.* 57D (Nov. 20).

317. *Turbo case, supra*, note 212, 55C (March 12), [*Turbo Resources Ltd et al. vs The Ontario Securities Commission* (S.C.D.C.)].

318. *Turbo case* [reasons], *supra*, note 212, p. 85C. The OSC used the term *takeover* rather than *agreement*.

319. *Ibid.*

> would be the price paid in a "normal" market, being one in which there is neither any undue selling pressure nor undue buying demand distorting the "market price".[320]

In cases where a market price already exists for the securities to be offered, that market price will be determined accordingly. The key question will be whether the market price was a normal one, free of any undue selling pressure or buying demand resulting in a distortive effect upon the market price.

An attempt to define what a selling pressure may be, or any other criteria found in the test laid down, is a hazardous enterprise. These features must be evaluated in the light of the specific market situation in each case because of their factual character. Their determination belongs solely to financial experts from brokerage firms.

As when s. 99(b) is used, the Commission must rely upon expert testimony to decide whether there was a pressure and whether it distorted the market price. Until decided, no one can really know whether the market price was normal or abnormal, a statement of fact *perse* frustrating.

110. The next question the OSC addressed in the *Turbo case* was whether the amount of the consideration was at least equal in value to that paid in the takeover bid. Put in a different way, whether $13.13 paid in July was still worth $13.13. Indeed, the Commission took the position that the operation of high interest rates could modify the amount proposed to be offered to minority shareholders [321]. Since controlling shareholders are often paid cash for their block, they can profit from the reinvestment thereof, an advantage denied to other shareholders.

This matter has been dealt with in *McLaughlin* [322] and in the *Turbo case*, although no decision has been reached. The Commission, in a *dicta* to its Turbo decision, clearly suggested the position it was expecting from purchasers of control:

> [i]t is obvious from any reasonable basis of comparison that $13-1/8 paid in March 1982 is of less value than $13-1/8 paid in July 1981.[323]

111. It results from that position that complying with s. 91(1) will now be almost more onerous than with s. 91(3). An equality in the consideration was thought to give more flexibility to offerors; it now provides complete equality, but little flexibility.

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320. *Id.*, p. 86C.
321. See *supra*, note 314.
322. *McLaughlin, supra*, note 3 and 300, pp. C7–C9 [Jan. 8].
323. *Turbo case, supra*, note 121, 86C.

112. The *Interim Report* has put forth new suggestions to respect such equality while reducing the purchaser's burden by providing him with an alternative manner to complete the follow-up offer. The purchaser could either make a general offer at a consideration per security at least equivalent in value to the greatest one paid under any of the private agreements, or offer to pay a consideration equivalent in value to the highest premium paid by the purchaser per security under any of the private agreements [324]. The *Report* however suggested tax changes before the latter measure be implemented.

113. The minority shareholders would not suffer any adverse effect; they would get the excess premium paid and would keep the opportunity to either retain or sell their shares in the market. A reasonable premium would be paid to the control block seller. Indeed, that proposition attempts to bring the follow-up offer back to a sale of a control block at a premium unavailable to the minority. Whether this move is possible, taking into account the context in which s. 91(1) has been interpreted as well as the behavior of both majority and minority shareholders, is a question to which a clear cut answer will unlikely be provided in the near future. Unless the concept of equality of treatment is revised, the suggestions of the *Interim Report* might remain suggestions for an undetermined period of time.

### 3.2.3. Attempt to avoid the follow-up offer: anti-avoidance rules

114. The follow-up offer requirement may also be triggered by transactions other than the private agreement. These transactions, which may be termed "indirect deals", have as their objective the avoidance of the follow-up offer. Although they may be framed in a perfectly legal manner, they obviously go against the spirit of s. 91(1), thereby attracting the attention of the Commission. Two schemes may be principally used; the said transaction may take place outside of Ontario, or on the other hand, a legal structure or another exemption may be inserted between the effective seller and the purchaser of control.

115. The fact that the agreement pursuant to s. 88(2)(c) is an exempted takeover bid is of some assistance when studying the problem of transactions taking place outside of Ontario. Technically speaking, the Ontario legislation applies as soon as an offer is made to at least one security holder whose address in the books of the offeree company is in Ontario, regardless of the point of origin of the takeover bid. The fact that an exemption under s. 99(e)

324. *Interim Report, supra*, note 16, p. 234A. It must be noted that none of the recommendations are based upon that suggestion; p. 236A.

may be sought in order to be exempted from the *1978 Act* requirements where only a few security holders are in Ontario does not alter the principle. Even though "it is questionable whether Ontario could require purchasers in other jurisdictions to make offers to Ontario vendors" [325], the actual wording of s. 88(2)(c) seems to permit such an interpretation. The focus of the legislation is not on the place where the transaction happens, but rather on whether Ontario security holders are affected. Where there is no takeover bid under the *1978 Act*, it is obvious that s. 91(1) cannot apply, not because the transaction takes place outside of Ontario, but rather for the reason that Ontario law does not apply.

116. Despite this finding, the Commission decided in several cases to prevent certain transactions from being completed by using cease trading orders or removals of exemptions. A good example available is the *Universal Explorations* [326] case, wherein the OSC staff argued that two Alberta corporations should respect s. 91(1) when using the Ontario market: no decision has yet been released, but Universal was banned from trading in Ontario.

117. This manner of proceeding raised critical comments from securities practitioners. The *Interim Report* clearly stated that the OSC was loosing credibility by pressuring non-Ontario persons to comply with s. 91(1) on a voluntary basis, through the use of cease trading orders, and that it could not reasonably impose its view of the public interest to a jurisdiction not holding the same opinion [327]. The Commission justifies the extra-territorial application of the *1978 Act* on the basis that it is required to preserve the credibility of the Ontario marketplace [328]. The extent to which that credibility has been affected so far by such types of deals is unknown. The fear that residents will deliberately avoid s. 91(1) by incorporating outside of Ontario or structuring their deals to avoid the Ontario legislation has not been established and appears to be an insufficient argument to explain the OSC's position. The converse would also be true, that is shareholders electing to obtain an Ontario residence to take advantage of s. 91(1). In any event, the fear that Ontario law becomes meaningless for anyone but the uninformed does not reflect the real situation. Wealthy shareholders, although minority ones, able to afford legal fees, have sought orders and rulings with the objective that a follow-up offer be paid. This should be looked at by the Commission when assessing the credibility of the Ontario marketplace, a concept which may otherwise become meaningless.

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325. See (1978) *O.S.C. Weekly Summary*, Supp. X, April 7, p. 3.
326. See *supra*, note 316; *The Globe and Mail*, Jan. 16, 1982, B-5.
327. *Interim Report, supra*, note 16, pp. 236A–238A.
328. *Chairman's Report, supra*, note 7, 83A.

118. The use of another legal structure to avoid the follow-up offer is a more complicated problem. To deal with this type of transaction, s. 91(2) was introduced in the *1978 Act*. This section is intended as a solution to schemes whereby private companies and the private company exemption are used where the private agreement one is unavailable. In a typical transaction of this sort, shares from individual sellers are transferred to a private company, within or outside of Ontario, and then resold under the private company exemption, while the economic benefit of the premium is available to the individual seller [329]. Previous attempts were made to solve this problem, but all were heavily criticized [330]. Section 91(2) was then introduced in Bill 7, which is

> [...] designed to impose the same obligation to make a follow-up offer on an offeror who, in the circumstances set forth in subsection 91(2), relies on an exemption other than the private agreement exemption and pays more than a 15% premium for the securities acquired.[331]

119. The section applies to every form of takeover bid, regardless of the fact it is exempted under s. 88(2). Two conditions must be fulfilled before the section is applicable. The takeover bid must result in the acquisition by the offeror "of the power or authority to control the business or affairs of the offeree company" [332]. Such an acquisition then has to result in a subsequent acquisition of the indirect power or authority to control what the *1978 Act* calls a "true target company" [333]. Although it is unclear what will constitute an acquisition of control under the *Act*, the language used in s. 91(2)(a) is similar to that in s. 99(a). The same criteria should apply under both sections in determining what "control" is [334]. The second condition is that such an acquisition of control must form,

> [...] to the knowledge of the offeror, part of a series of transactions initiated by a present or former holder of securities of the true target company who formerly had the power or authority to control the business or affairs of the true target company, the principal purpose of which was to permit the indirect sale of some or all of his securities of the true target company in a manner that would avoid the application of subsection (1) [335].

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329. See *supra*, note 325; see also *Control Block Transactions, supra*, note 90, p. IV–112, 13; *Alboini, supra*, note 4, pp. 682-83.
330. *Alboini, supra*, note 4, pp. 682.
331. *Id.*, p. 730. He gives an example of such a transaction. It must be noted however that s. 91(2) is not restricted to cases where a private company is used. See *Control Block Transactions, supra*, note 90, p. IV–113.
332. *1978 Act, supra*, note 1, s. 91(2)(a).
333. Such a corporation must be a public corporation.
334. See *infra*, # 157 to 161.
335. *1978 Act, supra*, note 1, s. 91(2)(b).

This second condition narrows the application of the entire s. 91(2) by relying upon the purchaser's knowledge of the scheme effected by the control block seller[336]. In this connection, a question arises. It has been suggested that the purchaser's knowledge involves two steps; (1) awareness that his takeover bid forms part of a series of transactions initiated by the present or former holder of control of the true target company; (2) awareness of the principal purpose of such series of transactions, *i.e.* the avoidance of s. 91(1)[337]. Does this mean that s. 91(2) will not apply where the purchaser is aware of only one of these items, or does it mean that the knowledge of either is sufficient to invoke s. 91(2)? If the former is the case, both criteria must be satisfied. Moreover, neither a burden of enquiry nor an "ought to know" test are found in s. 91(2)[338]. When considered in connection with the prerequisite condition that the seller must be in possession of control before the scheme takes place[339], and the fact that he must be an Ontario resident, these omissions could seriously restrict the use of the true target company provisions.

120. Where all the conditions of s. 91(2) have been satisfied, all the transactions initiated by the holder of control of the true target company will be set aside. The acquisition effected by the offeror is deemed a takeover bid in respect of the securities of the true target company made in reliance upon the private agreement exemption. The consideration paid for the acquisition thereof will be deemed the consideration received by the former holder of control who initiated the series of transactions.

## 4. The non-application of the follow-up offer: the exemptions and their underlying motivations

### 4.1. The need for policy requirements

121. The commission has been given in the *1978 Act* wide discretionary powers which are set out in s. 99 of the *Act*[340]. Section 99(b) as well as s. 99(c) have already been dealt with above and will not be raised again[341]. Suffice it to say these two sections provide the Commission with the authority to solve technical difficulties related to a potential application of the follow-up offer. On the other hand, sections 99(a) and 99(e) raise substantial questions upon

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336. See *Alboini, supra*, note 4, pp. 730-31.
337. See *Control Block Transactions, supra*, note 90, p. IV-113-14.
338. See *Alboini, supra*, note 4, pp. 730-31.
339. *Id.*, p. 731.
340. These discretionary powers obviously do not preclude the Commission from exercising other powers found elsewhere in the *Act*, such as the cease trading order pursuant s. 123.
341. *Supra*, #99 and ff, and #107 and ff.

the application of s. 91(1); only these two will be considered here, together with the *Addendum* to *Policy 3-37.*

122. To illuminate circumstances under which the OSC would exercise its discretion to grant exemptions from s. 91(1), guidelines were released by the Commission. Indeed, they were requested by the Minister responsible for the *Act* when he appeared before the Standing Committee of the Administration of Justice [342]. In his statement, he said he had instructed the OSC to prepare guidelines indicating the basis on which the Commission's discretion would be exercised. This mandate has been carried out through the release of a first request for comments in August 1978 [343], followed by a second one [344] and then a final Ontario Policy numbered 3-41 [345].

123. A first reason underlying the need for policy statements lies in the fact that an unlimited application of s. 91(1) was seen as undesirable. Both the Minister and the OSC, relying on economic considerations, acknowledged that the effect of the follow-up offer could be to prevent some desirable transactions [346] from being completed. The Commission was sensitive to opinions opposing the follow-up offer, at least conceptually. Referring to the majority's opinion of the Select Committee as well as to some comments from the private sector, the OSC declared that disincentive of entrepreneurship and economic onus for the purchaser dictated "a careful review of the policy considerations supporting the follow-up offer obligation" [347]. Put in a different way, the Commission was attempting to narrow the range of cases where the follow-up offer should be applicable. Relying upon the broad discretionary power given to it by the Legislature, the Commission stated it was directed

> [...] to focus the follow-up offer obligation on those cases in which it is clearly appropriate, after allowing for any potential negative impact on such matters as entrepreneurship and the incentives to expand small companies through public issues.[348]

342. *Supra,* note 5.

343. *Exemptions from the Obligation to Make a Follow-up Offer After a "Control Block Premium" Transaction,* (1978) *OSC Weekly Summary,* Supplement X, 11 August 1978 [hereinafter referred to as *August '78 request for comments*].

344. *Request for Comments Application for Exemptions Pursuant to Section 99 From the Obligation to Make a Follow-up Offer Pursuant to Section 91(1) After a "Control Block Premium" Transaction,* OSC, 22 Feb. 1979, but unfortunately unpublished in the *Weekly Summary* [hereinafter referred to as *Draft* or *Draft Policy*].

345. O.S.C. Policy No. 3-41. *Take-Over Bids – Section 99 Applications For Exemptions From the Obligation to Make a Follow-up Offer After a "Control Block Premium" Transaction – The Securities Act, 1978. (1979) OSC Weekly Summary,* Supplement C, 17 August 1979, from p. 173 to 182 [hereinafter referred to as *Policy* or *Policy 3-42*].

346. Minister's statement, *supra,* note 5.

347. *Draft Policy, supra,* note 344, p. 9.

348. *Id.*, p. 8.

This need to restrict the applicability of s. 91(1) was also based upon the policy consideration underlying the *Act, i.e.* the credibility of the market-place. Moreover, the fact that the *City Code* principle has not been followed in the U.S., although courts had intervened where minority shareholders were abused, was another incentive for the OSC to attempt to specify cases where an exemption from s. 91(1) would unlikely to be granted.

124. A second reason is framed upon an obligation owed by the Commission to provide the business community with some sureness [349]. The uncertainty created by the exercise of discretionary powers, as well as the need to ensure some form of fairness for both applicants and the Commission, were arguments relied upon by the OSC as justifying the existence of guidelines [350]. These would also serve as an attempt by the Commission to facilitate its administration of the *Act* by reducing the length of hearings, although the *Policy* was not to be understood as meaning that applications were no longer required.

125. As a third reason for the release of policy guidelines, based upon both a limited application of s. 91(1) and the need for certainty, the OSC stressed its duty to balance the costs against the benefits in each application submitted. This argument was first found in the *August '78 request for comments*, which was reissued in February 1979. Examples of cases where the requirements of a follow-up offer was outweighed by economic considerations were released by the Commission. Indeed, an exemption would receive favourable consideration in such cases even though the result to the remaining shareholders was unfair.

These grounds led the Commission to set up, in the *Draft Policy* as well as in the *Policy*, two general categories of transactions, one of cases where an exemption would unlikely be granted, and the other listing examples where an exemption would probably be granted even though such transactions might also fall within the first category.

### 4.1.1. The first category

126. In the *Draft Policy* are listed three major situations "[...] in which the application of the new statutory obligation seems appropriate" [351]:

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349. *Id.*, p. 12. The Commission added that

> [w]here legislative or regulatory entry is proposed into a new area of business endeavour, *the initially adopted requirements should be limited to what is required to meet the clearly discerned problem and subsequently expanded if and only to the extent that a need for expansion is discated by such experience*. Emphasis added. *Ibid.*

350. *Ibid.*

351. *Draft Policy, supra*, note 344, p. 14.

(a) A sale of control where the result is clearly unfair or abusive to the remaining shareholders;

(b) The sale of control follows a public distribution of equity securities of the same corporation (whether newly issued or derived from the control block) in which it may reasonably be assumed that investors relied on continued involvement of the controlling shareholder in the corporation's affairs, and the sale of control occurs within a reasonable period — to be determined on the particular facts but ordinarily approximating ten years — after the public distribution;

(c) The offeror proposes obtaining effective control at a premium through purchases from fewer than fifteen shareholders, none of whom individually has effective control, at a premium unavailable to the remaining shareholders.[352]

The first one was obviously making reference to the American law on the sale of assets, while the two others were designed to answer specific difficulties encountered in Ontario. Where the transaction underlying an application pursuant to s. 99(e) did not fall within any of these three, the Commission said it would "[o]rdinarily [...] be prepared to favourably consider granting an exemption"[353] from s. 91(1). In the interim conclusions of the *Draft*, the OSC went even further:

> In *all other circumstances* the Commission because of the perceived need to encourage entrepreneurship and the benefit to the remaining shareholders of a new controller able to more effectively manage or reallocate the assets of the corporation, *will weigh these factors favourably* in its review of the application.[354]

127. In *Policy 3-41*, the Commission became more precise. While repeating that it would be "favourably disposed"[355] to relieve an applicant from s. 91(1) where the transaction entered into did not fall within any of the situations specified, it said that such an exemption from the follow-up bid would be granted "[...] unless other circumstances indicate that the exemption would be contrary to the public interest"[356]. It further stated that even though the said transaction fell within one of the situations, it might still "give favourable consideration"[357] to an application for an exemption based on one of the guidelines listed in the *Policy*.

128. This first category, *i.e.* cases where a follow-up offer would be required, has been underestimated by applicants when submitting requests under s. 99(e). It must be noted that the confusion partly results from the

352. *Draft Policy, supra*, note 344, pp. 19-20.
353. *Id.*, p. 15.
354. *Id.*, p. 20, Emphasis added.
355. *Policy 3-41, supra*, note 345, p. 178.
356. *Ibid.*
357. *Id.*, p. 179.

language both of the *Draft* and of the *Policy*. The latter was indeed understood as taking

> [...] *the view that an exemption from the obligation should be available in all* situations except the three kinds of circumstances described therein. [...] [e]ven in those situations, there are circumstances in which the OSC would be favourably disposed to granting an application for an exempting order.[358]

The fine distinction between the *Draft* and the *Policy, i.e.* the reliance upon the public interest, was not stressed. This reference to the notion of public interest slightly altered the procedure to be followed in an application under s. 99(e). The examples provided were no longer the only cases where an exemption would not be granted. The evidence to be submitted to the Commission was no longer solely for the purpose of demonstrating whether or not the transaction underlying the request for an exemption would fall within the first category. The applicant would rather have to establish that the exemption sought would not be prejudicial to the public interest, the Commission being allowed, in determing that, to take into account all relevant circumstances[359]. The first category was simply illustrative of transactions clearly contrary to the public interest, and where no equality of treatment was given to minority shareholders[360]. To seek an exemption based on the argument that the relevant transaction did not fall within any of the three examples was therefore an underestimation of the scope of s. 99(e).

129. The decisions in which the first category was discussed[361] illustrate however that the Commission is divided upon the manner in which exemptions should be granted. In one case, the Commission extensively construed the obligation to make a follow-up offer while in another decision, it followed more strictly the text of *Policy 3–41*.

130. *Newsco* is the first decision where the OSC gave a broad interpretation to the *Policy*, and as a consequence thereof, to the obligation

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358. *Control Block Transactions, supra*, note 90, p. IV-99.

359. This criterium was already present in the *August '78 request for comments, supra*, note 343, p. 1. See *infra*, note 364 and # 179.

360. *The Interim Report* said that the theoritical basis of the follow-up offer, i.e. the acquisition of control at a premium, was altered by *Policy 3–41*. See p. 228A. It is submitted that it is the application of *Policy 3–41* which led to misunderstanding and underevaluation of s. 91(1).

361. Besides *Atco* and *Newsco*, two rulings were issued pursuant to s. 99(e) and related to s. 88(2)(c), where an exemption from s. 91(1) was granted. *Brinco Ltd*, (1980) *O.S.C. Weekly Summary*, Nov. 14, 19A ; *Ziebart Corp.*, (1981) 1 *O.S.C.B.* 5B (Jan. 9). An order under s. 99(e) denied an exemption : *In the Matter of Mineral Resources International Limited*, (1982) 3 *O.S.C.B.* 114B (Feb. 12). The decision *In the Matter of Hudson's Bay Oil and Gas Company Ltd, and Dome Energy Limited*, (1981) 2 *O.S.C.B.* 44C (Sept. 25) was not a case falling therein.

to make a follow-up offer. The facts of the case read as follows: F.P. Publications Ltd, a closely-held corporation, held 51.6% of Ronalds Federated. Five investors were owning F.P. with almost similar ownership, Newsco being one of them with a holding of 22.5% in F.P. Publications. In February 1980, Thompson Newspapers Ltd purchased all outstanding shares of F.P., but with the exception of the Newsco holding. Later in March, discussions were held between Thompson Newspapers Ltd and Newsco in respect of the Newsco ownership in F.P. On a suggestion made by Thompson Newspapers, Newsco agreed to sell its F.P. holding in exchange for the purchase of the Ronalds Federated's block owned by F.P. This transaction took place at the end of April 1980, and Newsco acquired the 51.6% of Ronalds from F.P. Publications at a price of $30, this price being above the market price as determined under the *Act*. Newsco was therefore obliged to make a follow-up offer to all remaining shareholders of Ronalds Federated.

The applicant stressed that the deal entered into did not fall within any of the situations set up in *Policy 3-41* [362]. For the same reason, staff counsel argued that Newsco should be exempted [363]. The Commission answered in these terms:

> [t]he Commission *may only grant an exemption* where it is satisfied that "... it would not be prejudicial to the public interest to do so." Thus in deciding whether or not an exemption should be granted, *all the relevant circumstances are open for investigation.* This is particularly true if there is any question as to whether or not the result of the sale of control is unfair to the remaining shareholders. We do not intend by these reasons to dilute the importance to an applicant of a finding that sale of control falls within none of the three circumstances in Policy 3-41 noted above, *but we do wish to emphasize that the Policy clearly states that such a favourable finding may not result in an exemption if "... other circumstances indicate that the exemption would be contrary to the public interest." This, of course, is a restatement in the Policy of the statutory obligation imposed* on the Commission under s. 99(e).[364]

The transaction was found to be unfair to the remaining shareholders [365] thereby falling within the first category set out in the *Policy*. The exemption was therefore denied as contrary to the public interest.

131. The decision in *Atco* attempted to follow the *Policy* in a more straightforward way. In this instance again, the applicant urged the Commission to apply and follow *Policy 3-41* [366]. The first part of the majority's

362. *Newsco, supra*, note 249, pp. 309-10.
363. See J. WILLOUGHBY, "OSC reserves decision on Webster exemption bid", *The Globe and Mail*, May 22, 1980, B-4.
364. *Newsco, supra*, note 249, p. 312; *Atco, supra*, note 158, pp. 419-20. Emphasis added.
365. See *infra*, s. 4.3.1.1.
366. *Atco, supra*, note 158, p. 419.

decision applied the broad interpretation pattern by generally adopting what was said in *Newsco*, and indeed repeated parts of this judgment[367]. Then, relying upon the criteria used in *Newsco* to determine whether the transaction was unfair or abusive, the majority decided that these elements were not present in this case: the transaction was not unfair or abusive to the remaining shareholders[368]. Being therefore outside the scope of the first category set out in *Policy 3-41*, the majority granted the exemption[369]. It did not look to other circumstances which would have indicated that the exemption was contrary to the public interest. Moreover, it relied upon the fact that the case fell within example (a) of the guidelines[370].

132. The Vice-Chairman and another commissioner disagreed on the issue of s. 99(e) for similar reasons:

> [t]he principles to be applied are reviewed in the majority decision. In the end result I was not persuaded that to grant the application would not be prejudicial to the public interest.
>
> It is apparent, as a result of arguments presented in both this and the earlier Newsco application referred to in the majority decision, that O.S.C. Policy 3-41, published prior to the coming into force of the Act in an attempt to give some guidance in a very vexing area, has taken on a life of its own in the eyes of some readers beyond that which at least some members of the Commission anticipated.[371]

These reasons are more in accordance with what was decided in *Newsco*, that is whether the transaction is prejudicial to the public interest. Of course, if the transaction falls within the first category, the application will very likely be denied[372]; where such is not the case, it must be decided whether the public interest is jeopardized as a result of the transaction. And *vice-versa*, where the transaction is viewed as prejudicial to the public interest, it is useless to argue that it does not fall within the first category of *Policy 3-41*. Indeed, as determined in *Newsco*, the *Policy* and s. 99(e) have to be read so as to give effect to both of them.

133. It seems clear that the majority in *Atco* did not follow such a pattern. By relying in a more strict manner upon the *Policy*, they prevented

367. However, they said this: "[w]e took the opportunity in the Newsco case to set out our view of how the policy statement ought to be interpreted and how it interacts with the terms of section 99 of the Act. We do not intend to repeat [...] but we adopt what was said on that occasion." *Atco, supra*, note 158, p. 419.

368. *Id.*, p. 422.

369. *Id.*, p. 423.

370. *Ibid.*, see *infra*, # 188.

371. *Id.*, p. 424.

372. See *Newsco, supra*, note 249; the guidelines may however be relied upon when seeking an exemption from s. 91(1). See *infra*, # 135.

themselves from looking at other reasons in determining whether the transaction was prejudicial to the public interest. It is not submitted that the result would have been different if the majority had made this further step. Perhaps it would not have found other circumstances leading to the conclusion that the deal was prejudicial to the public interest; on this point however, two members disagreed. In *Newsco*, such an enquiry was unnecessary, the transaction falling within example (a) of the first category. What is really different from *Newsco* in the *Atco* majority reasons, and which is viewed as a more restrictive approach, is that the enquiry was not held. Once it had decided that the transaction was not unfair, it granted the exemption. It is true however that the reliance on example (a) of the guidelines might explain the procedure used[373]; but if such is the case, it is unclear why the majority first ruled that the transaction was not unfair, this finding being useless if guidelines are used[374].

134. It is therefore unknown how the Commission will proceed on the next application solely pursuant to s. 99(e) and the first category. It must also be noted that the composition of the tribunal was similar on both occasions. Commissioner Thom dissented two times, the Vice-Chairman only in *Atco*. Finally, both cases were heard as the OSC Chairman was leaving, with the result that neither the former nor the present Chairman attended the hearings.

### 4.1.2. The second category

135. The second general category was initially outlined in August 1978. Although the OSC noted it would be impossible "[...] to state with certitude that an exemption would be granted in any specific type of situation"[375], all surrounding circumstances having to be taken into consideration, the Commission released examples of cases where imposing a follow-up offer "[...] would be more than outweighed by the economic costs"[376]. In these cases, the OSC would be willing to exempt a purchaser from s. 91(1) "[...] unless countervailing circumstances are present"[377].

136. The three examples put forth in the *August '78 request for comments*, as well as others, are found in the *Draft Policy*. Moreover, the Commission declared it would favourably consider granting an exemption from s. 91(1) where one of the guidelines is relied upon, even though the

373. Such is only a *dicta* however.
374. See *infra*, # 135 and # 183.
375. *August '78 request for comments, supra*, note 343, p. 1.
376. *Ibid.*
377. *Ibid.*

transaction falls into the first general category[378]. The guidelines were based upon economic considerations and were illustrative of the OSC's responsibility to balance costs against benefits. The *Policy* uses the same language as that in the *Draft*, and speaks of guidelines which represent the kind of circumstances where, even though the transaction falls within the first category, the Commission might relieve an offeror from making a follow-up offer[379]. The same examples are also listed in the *Policy*.

137. It might be said that the guidelines illustrate cases where it would not be prejudicial to the public interest to grant an exemption[380]. In this case, the logic underlying s. 99(e) is respected. It is also possible to see the guidelines as situations under which the principle of equality of treatment will be analyzed by the Commission in an attempt to provide both majority and minority with a fair result. Such should be a good example of a cost-benefit analysis, and would as well respect the philosophy of the *1978 Act* and the *Kimber Report*[381].

138. However, guidelines could also be viewed as examples of transactions where the notion of public interest is replaced by an economic calculation of the costs against the benefits. In this case, the philosophy underlying the follow-up offer would seem to be less respected.

This last hypothesis may easily raise substantial criticisms. It could be questionable to use economic considerations as superseding the legal principle of equality of treatment. From the conceptual point of view, an exemption is usually found either because the situation exempted does not need to be regulated, or is beyond the scope of the general rule. Such was indeed the spirit of the securities acts where the concept of "public" was justifying the availability of exemptions from registration and from filing a prospectus[382]. Particular categories of investors were exempted because they were subject to different legislation. On the other hand, those who were not members of the "public" were also exempted, the protection provided by the securities acts being useless in respect of these investors. By using other considerations unrelated to the spirit of s. 91(1), the guidelines released seem to go against such a structure.

139. Even more questionable than the use of these economic reasons to set aside the equality of treatment is the granting of an exemption in

378. *Draft Policy, supra*, note 344, p. 15; see *infra*, note 379.

379. *Policy, supra*, note 345, pp. 178-79.

380. This was exactly the case in *In the Matter of Hudson's Bay Oil and Gas Company Ltd. and Done Energy Limited, supra*, note 361, p. 45C, and the ruling at p. 149B (Sept. 18).

381. *Ibid.*

382. Such is still the case in jurisdictions other than Ontario, *e.g.* Québec.

reliance on these guidelines even though such would produce an unfair or abusive result *vis-à-vis* the remaining shareholders. The balance of costs against benefits should not be a technique used to take advantage of minority security holders, especially in a market situation where takeover bids are so frequent. The basic philosophy of the takeover legislation in Ontario is based upon a double test: the protection of offeree shareholders, with the limitation that such protection would not unduly impede potential bidders, or put them in commercially disadvantageous positions [383]. In other words, offerors as well as offerees ought to be treated with fairness [384]. To permit the abuse of one side in order to give the other side an advantage is a misunderstanding of the basic philosophy of fairness.

140. It can easily be understood that flexibility is needed in respect of the follow-up offer requirement, and that offerors should not be precluded from implementing useful transactions. In fact, such reasons may efficiently temper the notion of what is prejudicial to the public interest. However, such a balance must really work between two opposite interests so as to provide them with the same fairness, and not a different connotation of what constitutes fairness depending upon the situation.

### 4.1.3. The nature of the OSC policies and their legal consequences.

141. It would not be surprising to say that the manner in which the OSC will exercise its discretion is now rather undetermined. To be more accurate, the *Policy* can no longer be relied upon [385] to suggest in which circumstances an exemption from s. 91(1) could be granted. It is even possible to say that reliance on the *Policy* might be ill advised since it could lead to the refusal of an exemption [386]. This tendency has been strongly opposed by applicants who have urged the OSC to follow and respect its own policy statements. These affirmations led the Vice-Chairman to note that the *Policy* "[...] has taken a life of its own in the eyes of some readers" [387]. Indeed, one might have the impression that the spirit of s. 91(1) is no longer to make an equivalent offer to remaining security holders, but rather to attempt by every means possible not to make such an offer. That

383. *Kimber Report, supra*, note 29, #3.10.

384. Equal treatment and equal access to the relevant information are designed to achieve such a balance. See *supra*, #12.

385. J.C. BAILLIE, "Shareholders' Remedies", *The Law Society of Upper Canada*, The March Special Lecture Series, 1981, March 5, 1981 [copy from the author's original], p. 14, see *supra*, #144.

386. See *McLaughlin, supra*, note 3. Indeed, the "proposed interpretation" found in *Policy 3-41* and the OSC interpretation of s. 91(1) oppose one another.

387. *Atco, supra*, note 158, p. 424.

this is a retrogressive step appears likely [388], but would not be unique in the history of application of securities laws in North America. Practitioners have for a long time attempted to find ways to avoid being subject to the legislation [389].

142. The uncertainty surrounding the application of *Policy 3–41* raises broad questions, some of them related to the duty owed by the Commission to respect its own policies as well as to their legal forcefulness.

143. The OSC power to issue policy statements is undoubted. The modern legal literature [390] agrees that the release by an administrative body of criteria upon which its discretion will be exercised "[...] enhance[s] the effectiveness of the administrative process" [391]. The rule-making process has

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388. J.C. BAILLIE, *supra*, note 385, p. 14.
389. This concern is not particular to Ontario ; see *Commission Recommendation, July 25, 1977, concerning a European Code of Conduct Relating to Transactions in Transferable Securities, supra*, note 26, wherein the European Commission refused to set out a list of examples where the principle of equality of treatment should be respected where control is sold. It said that such a list would create loopholes which would rapidly be used : see p. L212/39. In Canada, see the legal battles of the securities commissions in relation to their territorial jurisdiction as well as to the definition of security, especially in respect of investments contracts.
390. See *e.g.* M. FILION, "Le pouvoir discrétionnaire de l'administration exercé sous forme de normes administratives : les directives", (1979) 20 *C. de D.* 855 ; W.J. ATKINSON, "La discrétion administrative et la mise en œuvre d'une politique", (1978) 19 *C. de D.* 187 ; J.M. EVANS, H.N. JANISCH, D.L. MULLAN, R.C.B. RISK, *Administrative Law. Cases, Texts, and Materials*, (1980), especially Chapter 11 ; H.N. JANISCH, "Policy Making in Regulation : Towards a New Definition of the Status of Independent Regulatory Agencies in Canada", (1979) 17 *Osgoode Hall L.J.* 46, esp. pp. 90–110 ; M.Q. CONNELLY, *Securities Regulation and Freedom of Information*. (1979) Commission of Freedom of Information and Individual Privacy, Research Publication No. 8.
391. Law Reform Commission of Canada, *Independent Administrative Agencies*. Ottawa, Minister of Supply and Services, 1980, Working Paper No. 25, p. 117. They explained for these reasons

> Increased rule-making would likely enhance the effectiveness of the administrative process. First, it is likely to provide for more efficiency in terms of time and expense. Rule-making is an effective way of communicating agency preferences, thereby promoting compliance with agency standards. The more issues are reduced to specific rules, the fewer will need to be debated in the context of a specific application. This can narrow the scope of adjudication. An agency might justify a fairly stringent standing requirement in a licence application, for example, excluding representations on issues which have been amply considered in prior policy-making proceedings.
> Second, the more policy is reduced to general rules, the more informed an applicant is of the considerations which bear upon his application. If he wishes to challenge the policy, he is at least aware of what it is beforehand. Along the same lines, the agency has been forced to take a position and is not likely to approach an application in a state of confusion about the policy governing the case.
> On a broader front, administrative rule-making and public participation therein indicate a new direction which the law has taken with the growth of the modern state.

been qualified as "[...] one of the greatest inventions of modern government"[392]. In relation to the OSC, whose major task is the protection of the public, the release of policy statements may be indicative of the types of behavior which might be considered prejudicial to the public interest. They might be extremely important for all participants in the marketplace. Policies may be quickly adopted to provide effective answers to new types of abuses taking place in the market[393]. Without broad discretion, the OSC would indeed be unable to fulfill its obligations.

It must however be kept in mind that these policies, or guidelines, are without legal effects[394]; they do not carry any compulsory requirements nor are they binding upon the authority which issues them[395]. They are rather indicative of the manner in which the discretion conferred will be exercised on specific applications[396]. In any case, they should not be an excuse for the agency to refuse to exercise its discretion and to simply rely upon a policy statement. Each application must be evaluated in the light of its particular facts. A policy cannot be used as a device to set up rigid requirements which have to be respected where specific findings are established, nor to prevent an application from being granted because the applicant did not follow the guidelines[397]. Along with this, a policy cannot contradict a clear legislative text[398].

144. The difficulty with the policies adopted by the OSC is that they have often been considered as legal requirements which ought to be

392. K.C. DAVIS, *Discretionary Justice*. Bâton Rouge, Louisiana State University Press, 1969, 65.

393. A good example is provided by Ontario Policy No. 3–37 and its supplements, which were adopted where going private and squeeze-out transactions were used to provide minority security holders with supplement of disclosure.

394. See *e.g. Capital Cities Communications Inc. v. Canadian Radio-Television Commission*, [1978] 2 S.C.R. 141, pp. 169–71; *Canadian National Railways Co. v. Bell Telephone Co. of Canada*, [1939] S.C.R. 308, pp. 318-19; *Sirois v. Université du Québec à Montréal*, [1974] C.S. 26; *Rossi v. The Queen*, [1974] 1 F.C. 531, p, 537; *Sarachman v. Commission des valeurs mobilières du Québec*, [1974] R.L. 462, p. 470; *Rehopedale Developments Ltd and Town of Oakville*, [1965] 1 O.R. 259, pp. 263–65; *Re Amstrong and Canadian Nickel Co. Ltd*, [1970] 1 O.R. 708, pp. 713-14.

395. See *e.g. Junior Mining Exploration and Development Companies*, Québec Securities Commission, Policy Statement No. 8, C.C.H. *Can. Sec. L. Rep.*, vol. 3, #66–019, pp. 11,007-3, OSC Policy No. 3.03, *Mining and Oil Companies: Vendor Consideration, Retained Interest, Escrow Agreements, Transfers and Releases From Escrow, Amalgamation and Escrowed Shares*, C.C.H. *Can. Sec. L. Rep.*, vol. 2, #54,897, p. 10264.

396. H.L. MOLOT, "The Self-Created Rule of Policy and Other Ways of Exercising Administrative Discretion", (1972) 18 *McGill L.J.* 310, pp. 313–16 and 341.

397. See *Re Phillips and Registrar, Mortgage Brokers Act*, (1978) 86 D.L.R. (3d) 158 and *supra*, note 390.

398. *Harel v. The Deputy Minister of Revenue of the Province of Quebec*, [1978] 1 S.C.R. 851, pp. 858-59.

respected : not only the text thereof, but the spirit as well[399]. That the policies do not have any legally binding force has never been taken into consideration. The fear of a cease trading order[400] or the prospect of being subject to OSC proceedings, these constituting the force of the Commission, are sufficient incentives for both businessmen and their lawyers to closely follow the policies[401]. To infringe upon one of them is therefore seen as a venture into troubled waters. Indeed, a powerful example of the way the Commission views its policies is found in the *National Sea*[402] case, in which the Uniform Act Policy 2-12[403] was simply considered as if it was a legal requirement to be respected. Such a result was achieved without any reference whatsoever to the legal nature of the *Policy*[404].

145. The National Policy requirements have been adopted in an attempt to provide both the regulators and the investors with a certain level of uniformity[405]. The fact that securities regulation is a field of provincial jurisdiction can explain this necessity. Issuers, where filing a prospectus in more than one province, were often facing different regulations and different technical requirements upon the same kind of information to be disclosed. To obtain a sort of uniformity and to prevent federal intervention was viewed as necessary.

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399. J.C. BAILLIE, *supra*, note 385, p. 11 ; M.Q. CONNOLY, *supra*, note 390, pp. 28-29 ; see also *In the Matter of Cablecasting Ltd*, (1978) *O.S.C. Bulletin* 37, p. 41 (Feb.).

400. *In the Matter of Cablecasting Ltd, supra*, note 399, p. 41 and pp. 43-44.

401. *Ibid.* ; J.C. BAILLIE, V.P. ALBOINI, "The National Sea Decision — Exploring the Parameters of Administrative Discretion", (1977-78) 2 *Can. Bus. L.J.* 454, p. 462, 468-69.

402. *In the Matter of Harold P. Connor, C.J. Morrow, W.E. Morrow, J.B. Morrow, C.R. Macfadden and J.B. Estey*, (1976) *O.S.C. Bulletin*, 149 (June) [hereinafter referred to as *National Sea Case*.

403. Uniform Act Policy No. 2-12 ; *Timely Disclosure* ; O.S.C. Policy No. 3-23 ; *Administration : Timely Disclosure : Uniform Act Policy 2-12*. C.C.H. *Can. Sec. L. Rep.*, vol. 2, # 54-882 and 54-917.

404. *National Sea case, supra*, note 402, p. 178 and ff ; see also *Notice OSC Staff Review of Certain Takeover Bid Circulars*, (1978) *O.S.C. Bulletin* 60 (March), where the Commission suggested informal discussions in respect of takeover bids by issuers and insiders, and the application of Ontario Policy No. 3.37. At p. 61, the OSC noted that "[i]f opportunity for staff comment is precluded by failure of the offeror to initiate these discussions at a sufficiently early time, the Commission will give serious consideration to an application from its staff for a cease trading order under s. 144". See also *Notice Re : Commission Enquiries — Take-Over Bid Legislation and Policy. Proposed Take-Over Bid for Noranda Mines Ltd, supra*, note 239 : "[w]hile it has [the OSC] no ground to believe that there have been violations of either the law or its published policies [...]".

405. See *e.g.* National Policy No. 1, *Clearance of National Issues*, C.C.H. *Can. Sec. L. Rep.*, vol. 2, # 54-838 ; National Policy No. 5, *Recognition of Profits in Real Estate Transactions*, C.C.H. *Can. Sec. L. Rep.*, vol. 2, # 54-842 ; National Policy No. 14, *Acceptability of Other Currencies in Material Filed with Provincial Securities Administrators*, C.C.H. *Can. Sec. L. Rep.*, # 54-851 ; Draft National Policy Statement, *Certified Feature Productions and Certified Short Productions*, (1980) *O.S.C. Weekly Summary*, Suppl. X-1, July 31.

146. Ontario policies are based as well upon a somewhat similar objective to provide the business community with more precise indications in respect of the application of the *Act*[406]. However, some of them are also designed to protect investors in certain circumstances. To a certain extent, it could be said that these policies are designed to provide protection in situations which might be prejudicial to the public interest[407]. Where a particular case does not fall within these situations, an exemption from the policy might be available[408]. The same pattern is also applied under the *Act*; where an exemption from specific requirements is sought, such an exemption might be granted as long as it would not be contrary to the public interest to do so[409]. The corollary of such a statement is obvious; to infringe upon a policy without having been exempted could be viewed as a behavior contrary to the public interest, so as to entitle the OSC to use the measures discussed above. Indeed, there is no choice but to respect very carefully every policy[410].

147. In this context, it is not surprising to realize that counsel for applicants have urged the Commission to follow *Policy 3-41*. The point is now that, as noted above, *Policy 3-41* is somewhat broad, using the test of prejudice to the public interest to determine whether the transaction can be exempted. Indeed, it could be said that *Policy 3-41* is no longer an attempt to provide certainty, inasmuch as the criteria relied upon are *per se* uncertain and vague. It cannot be said that the Commission does not follow its *Policy*, but rather gives to it either a broad or less broad interpretation, contrary to expectations. There is absolutely no doubt that the OSC is not legally bound by its policies; but a broad interpretation of s. 91(1), despite a policy statement emphasizing the need for a restrictive application of the follow-up

406. See *e.g.* O.S.C. Policy 3-60. *Prospectuses - General Guidelines*, (1981) 2 *O.S.C.B.* 107E (Dec. 18).

407. See *e.g.* O.S.C. Policy No. 3-25, *Mortgage and Real Estate Investment Trusts and Partnerships*, C.C.H. *Can. Sec. L. Rep.*, vol. 2, #54-919, Introduction: Background of Policy 3-25, p. 10286; O.S.C. Policy No. 3-34, *Timely Disclosure: Adequacy of Disclosure: Cease Trading Order in Other Jurisdictions*, C.C.H. *Can. Sec. L. Rep.*, vol. 2, #54-960; OSC Policy No. 3-37, *Issuer Bid — An Offer by an Issuer to Purchase, Redeem or Retire its own Securities: Timely Disclosure*, C.C.H. *Can. Sec. L. Rep.*, vol. 2, #54-963; *Appendix I Supplement to O.S.C. Policy 3-37*, C.C.H. *Can. Sec. L. Rep.*, #54-963a; *Policy 3-37 Interpretation — Exemptions*, C.C.H. *Can. Sec. L. Rep.*, vol. 2, #54-963b; see *McLaughlin, supra*, note 3, p. 112C-113C; *Torstar, supra*, note 8, p. 67C; O.S.C. Policy No. 3-41, *supra*, note 345; see new OSC Draft Policy 3-37, *supra*, note 220.

408. See *e.g.* O.S.C. Policy No. 3-37, 3-41 and Draft Policy 3-37.

409. See *e.g.* *In the Matter of Parts XVII and XX of The Securities Act, 1978 and In the Matter of Certain Reporting Issuers*, C.C.H. *Can. Sec. L. Rep.*, vol. 2, #54-971 [related to O.S.C. Policy No. 3-44]. See generally *Reporting Issuers Continuous Disclosure and Insider Reporting Requirements*, (1980) *O.S.C. Weekly Summary*, Supp. X2, July 31; C.C.H. *Can. Sec. L. Rep.*, vol. 2, #54-974.

410. *In the Matter of Cablecasting Ltd, supra*, note 399, p. 43.

offer, might result in a lack of confidence by the business community in the Commission.

148. To a certain extent, the Commission has been caught by the situation it itself created in interpreting policy requirements as if they were legal ones. The conflicts between *Policy 3-41* and the OSC interpretation of this *Policy*, as well as its broad application of s. 91(1), are also illustrative of the results produced by an increasing use of policies, compliance being based upon a cease trading order[411]. However, it is also indicative of the distortive effect created by the actual number of takeover bids taking place throughout North America. Private agreements are not only used to provide selected shareholders with financial advantages, but also as tactical manœuvers to achieve control in a takeover fight. What is often sought in these situations are technical applications of the legislation. Imperative guidelines, which have to be applied, would, to a certain extent, be used to circumvent the spirit of securities legislation, a result the Commission would unlikely find acceptable. As it said,

> [...] the Commission wishes forceably to draw to the attention of the public that, although technical interpretation is necessary, it is the expectation of the Commission that the participants in the capital markets of this province will be guided by the basic philosophy and rationale from which the securities laws of this province were developed. The sophisticated gloss of technicality must not be used to obscure the true intent and import of the basic philosophies that underlie the securities laws of the province. Technical interpretations that run contrary to these basic philosophies and principles will not be acceptable to the Commission.[412]

This latter reason is probably the most evident one at the present time. It has been noted that the OSC's decisions should be analyzed "[...] on a cost-benefit basis in light of medium and long term consequences as well as short term consequences"[413]. The application of s. 91(1) in fact has short term positive advantages for remaining shareholders, even though it seems questionable whether it is beneficial for minority shareholders in general[414]. In normal market situations, where takeover bids are a less frequently used measure, this statement is more than accurate. It is however unclear the

411. See the concern stressed by the former O.S.C. Chairman J.C. Baillie, *supra*, note 385, p. 12. See *Turbo case, supra*, note 212, pp. 82C-83C for an example of the underlying philosophy of the OSC while using cease trading orders and removal of exemptions in takeover bid contexts.

412. *In the Matter of the take-over bid by Federal Commerce & Navigation Ltd and In the Matter of the take-over bid by Olympia & York Investments Ltd, supra*, note 33, pp. 25C-26C.

413. J.C. Baillie, *supra*, note 385, p. 15.

414. *Id.*, p. 16. He gives an example where a decision to go public might be postponed, if not deleted; the range of new equity investments would therefore be less than it could have been.

extent to which the long term economic benefit may conflict with the Commission's duty to maintain the credibility of the marketplace. The actual situation raises serious concern among the general public about the fairness of such a marketplace[415]. To assure the public that the marketplace is fair to every investor is by itself a long term objective[416]. Equal access to information has been one method to achieve this objective. Equal treatment should simply be another way to reach the same one[417].

### 4.2. The exercise of discretion under s. 99(a)

149. The Commission possesses the discretionary power[418] to exempt a purchaser from making a follow-up offer where there is evidence that "the offeror will not or did not acquire through the offer the power or authority to control the business or affairs of the offeree company"[419]. S. 91(1) having been introduced partly as a response to abuses in sales of control[420], it seems logical that such a requirement may be waived where the control is not effectively acquired by the purchaser.

150. S. 99(a) focuses on the acquisition of control by the offeror rather than on the sale thereof by the seller[421]. For instance, a holding which *per se* does not involve effective control may be sold and provide the purchaser with such control where he already owns securities of the offeree company. From this purchase, the offeror will have acquired effective control.

It also seems that although any interested person might submit an application pursuant to s. 99(a), security holders who were not tendered a

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415. See "Exposed Shareholders", *The Globe and Mail*, edit. note, June 15, 1981 [following the O.S.C. decision in *BCFP-Noranda-AEC(2)* case].
416. See *e.g. T.S.E. Notice to Members No. 3038*, May 22, 1980.
417. See *e.g. McLaughlin, supra*, note 3, p. 114C; pp. 61-62. As noted above, the OSC involvement raises the question as to whether the equality of treatment is still desirable in Ontario. If the answer is yes, is the discretion conferred to the Commission the most suitable manner to achieve this equality?, or would it be more advisible that a single, absolute rule be adopted? The discretionary power given to the OSC is probably the most flexible one to face new market situations, but is also the most interventionism one. Every participant in the market place will have to bear and accept the drawbacks arising from the choice of policy made.
418. S. 99(a) gives to the OSC a discretionary power; the finding that control was either acquired or not does not automatically compel the Commission to issue and order pursuant to s. 99(a) exempting the offeror from s. 91(1). See *McLaughlin, supra*, note 3, 385C, p. 388C [Divisional Court] and the dissenting opinion in *Dataline, supra*, note 433.
419. *1978 Act, supra*, note 1, s. 99(a).
420. See *supra*, #2-7.
421. See *1978 Act, supra*, note 1, s. 99(a); *Alboini, supra*, note 4, p. 724. The *Interim Report* stressed that such a pattern was accurate taken into account the characteristics of the Canadian economy. See p. 229A.

follow-up offer will not be allowed to seek such an offer through a request under s. 99(a). This section is designed to exempt a purchaser from making a follow-up bid, not to require him to make one[422]. Indeed, the wording of s. 99(a) suggests that only the purchaser can find any advantage in applying for a ruling under s. 99(a).

151. Before being subject to s. 91(1) and to seek to be exempted from it, the definition of takeover bid must first be satisfied[423]; otherwise, the transaction is not subject to s. 91(1). Where the purchaser owns more than 20% of the offeree's voting securities, he is deemed to have acquired effective control[424]. His application under s. 99(a) will therefore attempt to reverse this presumption[425].

152. Where an application under s. 99(a) will be made[426], the applicant must give notice of his intention to do so to minority shareholders[427]. The manner in which notice will be given has to be set out in the application. Where the applicant wishes not to give such notice, he must submit valid reasons[428]. Different methods to make the minority shareholders aware of a request to be exempted from the follow-up offer include direct mailing[429], newspaper advertisement[430], releases to the financial press and wire service as well as a notice in the OSC Bulletin[431]. It must also be noted that the applicant may seek the advice of the Commission to determine which method should be used in respect of his request[432].

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422. *Alboini, supra*, note 4, p. 725.
423. See *supra*, #46-48.
424. See *Alboini, supra*, note 4, p. 723.
425. Stated in a more restricted manner, s. 99(a) may be relied upon by an offeror where he considers that "there is a real question as to such power or authority" was acquired as a result of an agreement. See *Policy 3-41, supra*, note 345, p. 177. The section is unavailable where control is already in possession of the offeror. See *McLaughlin, supra*, note 3, p. 104C, pp. 52-53, and *infra*, #157 and ff.
426. This applies for s. 99(e) as well.
427. See *Policy 3-41, supra*, note 345, p. 182.
428. See *e.g.* the application for exemption filed by McLaughlin, 5 March 1981, O.S.C. file No. 08381, p. 7. The applicant justified it on the ground that no change of control took place, but agreed to give notice to minority shareholders if a hearing was requested by the O.S.C. Such a notice would be given in the manner required by the Commission.
429. See *e.g. Newsco, supra*, note 249, p. 308. The Commission noted that

    [...] notice by mail to individual shareholders will not be required in all cases but that the matter is very much a question of the size of the company, the publicity attendant upon the particular transaction, the number of shareholders and their geographical location.

430. See *e.g. Atco, supra*, note 158, p. 414.
431. See for the *McLaughlin* case, (1981) I *O.S.C.B.* 26A, 27A (March 27).
432. In *Newsco, Atco* and *McLaughlin*, the O.S.C. requested the applicant to give notice to minority shareholders in the manner it indicated.

153. S. 99(a) contains unclear expressions. None of the words "power or authority", "control", "business and affairs" are defined. Moreover, the use of the expression "will not or did not acquire" adds to the uncertainty of s. 99(a).

154. The expression "power or authority" refers to effective or *de facto* control rather than the concept of legal control. In *Policy 3-41* as well as in the *Draft*, the Commission emphasized that the acquisition of the practical authority to nominate a majority of directors would be an element heavily relied upon in determining whether effective control has been acquired[433]. Indirect, limited or negative control would not constitute situations where the purchaser would be able to elect a majority of directors[434]. The *Draft* was even more precise, saying that the acquisition of effective control should be made without a proxy battle[435]. Moreover, the *Draft* adequately pointed out that such authority would be acquired where the agreement says that actual directors would resign to be replaced by the purchaser's nominees upon the closing of the transaction. This authority would also be obtained where directors "[...] feel a moral obligation to resign if requested to do so"[436]. Indeed, the "practical authority to nominate a majority of directors" is not an expression whose connotation is restricted to direct nominations or elections. Control may be achieved by a combination of resignations, an increase or decrease in the number of directors on the board, nominations and elections[437], where each mechanism is insufficient in itself to provide the offeror with effective control. The "practical authority" might therefore be understood as including every scheme whereby the purchaser places his nominees on the board as a result of the agreement, rather than focusing merely on the technique used to obtain the control position. It must be clear however that the new controller must obtain a majority on the board, and not simply several seats which would be insufficient to give him effective control[438].

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433. See *Policy 3-41, supra*, note 345, p. 177; *Draft Policy, supra*, note 344, p. 7. However, all relevant facts must be taken into account. *In the Matter of Dataline Inc.*, (1982) 3 *O.S.C.B.* 48C, p. 50C (Feb. 19), the majority of the Commission found that the offerors did not acquire that authority following a private purchase of shares representing 34% of the outstanding shares, another shareholder owning a 50.3% holding.

434. However, they might be viewed as materially affecting the control. See *infra*, # 158 and ff. The majority of the Commission implicitly confirmed that interpretation *In the Matter of Dataline Inc., supra*, note 433, 50C.

435. *Draft Policy, supra*, note 344, p. 7.

436. *Ibid.*

437. In such a case, the offeror is not given enough seats on the board; but timely resignations and an increase or decrease in the number of directors could give the offeror effective control, especially if he is entitled to decide who will replace the leaving directors.

438. *In the Matter of Dataline Inc., supra*, note 433, the offerors did not obtain any seat on the board with a purchase of 34% of shares.

155. The use in the *Policy* of the words "as a consequence of the private agreement" as opposed to "through the offer" as used in the *Act*, may raise a problem where resignations provide the purchaser with effective control. Where the resignations take place on the conclusion of the agreement, there is no difficulty; but where they occur several weeks or even several months later, the issue is whether they can still be viewed as being a consequence of the private agreement or, phrased differently, whether the purchaser acquired control through the agreement.

The resignations should be a direct consequence of the agreement, even though they occur several months later[439]. Where other steps are taken before the directors resign, the link between the agreement and such resignations may become indirect. It must be borne in mind that the OSC will take into consideration all relevant facts in reaching a conclusion on an application pursuant to s. 99(a). The personal willingness of one or some directors to quit should not be viewed as a direct consequence of the agreement where unrelated to the conclusion of the agreement. In fact, control should be a consequence of positive acts performed by the purchaser[440]. Only resignations solely motivated by the agreement should be taken into account. Otherwise, a personal reason would become the direct and the agreement the indirect cause. In any event, the resignation is the first step; if the purchaser does not have any control over the election or the nomination of the new director, he cannot be said to be placing his nominee on the board. In such a case, the resignation would not provide the offeror with effective control.

156. The meaning to be given to the expression "will not or did not acquire" may be explained in different ways. One consists in the fact that the offeror has acquired an important holding in the offeree company, although insufficient to give him effective control, and has contractually agreed not to increase such ownership[441]. The offeror would therefore be precluded from seeking the control of the offeree company in the future. Another one is related to the practical authority to nominate a majority of directors and the timing of an application pursuant to s. 99(a). Such an application by the purchaser may be submitted before the private agreement takes place. It might be difficult to know whether the applicant will acquire such an

439. Such a statement has however to be analyzed in light of the evidence submitted.

440. Indeed, the *Draft Policy* stressed that evidence from directors might be requested to determine whether they were asked to resign. But see *infra*, # 158 and 159.

441. *In the Matter of British Columbia Forests Products Ltd. Alberta Energy Company Ltd. Noranda Mines Ltd (Part II)*, (1981) 1 *O.S.C.B.* 177B (June 12) [ruling] and (1981) 2 *O.S.C.B.* 6C (July 24) [reasons] [hereinafter referred to as *BCFP-Noranda-AEC(2)* ]. See pp. 12C–15C.

authority upon the implementation of the agreement, especially where a combination of resignations and nominations of directors will give the offeror effective control[442]. In such a case, the weight given to the practical authority to nominate a majority of directors might be lessened in favor of other findings. However, where an application is submitted after the agreement has been reached, there is no doubt as to the reliance by the Commission upon such a practical authority in determining whether control was acquired[443].

157. By relying upon the notion of effective control[444], the OSC has clearly set aside that corporate control could only be achieved through *de jure* control. It is interesting to note that this concept was still in use by Canadian courts as recently as 1965[445]. Since the work published in 1932 by Berle and Means[446], it is acknowledged that an ownership of more than 50% is no longer required to run a company. Working or management control[447] is often sufficient to permit a small group of individuals with little ownership to direct the corporation[448]. Together with the fact that a corporation acts

442. See *supra*, note 416.

443. See *e.g. In the Matter of Dataline Inc.*, *supra*, note 433.

444. In the *McLaughlin* case as well as in *BCFP-Noranda-AEC(2)*, submissions were made in order to discover whether the control should be determined on a fully diluted basis [*McLaughlin*, *supra*, note 3, p. 105C; p. 54] or meaning legal, effective or absolute control. In *McLaughlin*, they were considered irrelevant, given the circumstances of the case. In *BCFP-Noranda-AEC(2)*, nothing was said in the decision; but see *infra*, #158. If the authority to nominate a majority of directors is still the main item on which the O.S.C. will rely in applications pursuant to s. 99(a), which was doubtful in the reasons released in *BCFP-Noranda-AEC(2)*, but became clear from the majority reasons in *Dataline*, these arguments could be viewed as useless because the manner control is obtained is more or less irrelevant. What is important is to be able to nominate the majority of directors.

445. See *e.g. Minister of National Revenue v. Dworkin Furs (Pembroke) Ltd*, [1967] S.C.R. 223; *Purdom v. Doherty*, (1929), 3 D.L.R. 719, p. 721; see also *1978 Act*, *supra*, note 1, s. 1(2), (3).

446. *Supra*, note 136.

447. *Id.*, p. 70 and following:

> Five major types can be distinguished, though no sharp dividing line separates types from type. These include (1) control through almost complete ownership, (2) majority control, (3) control through a legal device without majority ownership, (4) minority control, and (5) management control. Of these, the first three are forms of control resting on a legal base and revolve about the right to vote a majority of the voting stock. The last two, minority and management control are extra legal, resting on a factual rather than a legal base.

448. *Id.*, p. 69 where the authors stress that

> [u]nder the corporate system, control over industrial wealth can be and is being exercised with a minimum of ownership interest. Conceivably it can be exercised without any such interest. Ownership of wealth without appreciable control and control of wealth without appreciable ownership appear to be the logical outcome of corporate development.
> This separation of function forces us to recognize "control" as something apart from ownership on the one hand and from management on the other.

through its board of directors, these facts have led authors to propose new definitions which stress that control is the capacity to choose directors:

> [s]ince direction over the activities of a corporation is exercised through the board of directors, we may say for practical purposes that control lies in the hands of the individual or group who have the actual power to select the board of directors, (or its majority), either by mobilizing the legal right to choose them — "controlling" a majority of the votes directly or through some legal device — or by exerting pressure which influences their choice. Occasionally a measure of control is exercised not through the selection of directors, but through dictation to the management, as where a bank determines the policy of a corporation seriously indebted to it. In most cases, however, if one can determine who does actually have the power to select the directors, one has located the group of individuals who for practical purposes may be regarded as "the control."[449]

158. Before the decision in *BCFP-Noranda-AEC(2)*, the reference in the *Act* to the power to control "the business and affairs"[450] of the offeree corporation, as well as the forbiddance set out in the *Draft* from using proxies to nominate directors, indicated that control could have been viewed as being positive acts made pursuant to a sufficient ownership. In fact, negative control, *i.e.* the power to block transactions with a small holding, was not considered either by the *Act* or the *Policy*. Uncertainty has however been introduced in respect of this argument following the OSC's decision in *BCFP-Noranda-AEC(2)*[451]. In this one, the Commission, after it had referred to *Policy 3-41*, stated an opponent's argument in which it was argued that AEC and the two other major shareholders were forming a control group. Then, the OSC referred to s. 1(1)(11)(iii) and said that the tests to be applied in determining whether the sale of a control block was materially affecting the issuer's control were not dissimilar to those to be applied in respect of AEC's application[452]. However, the Commission did not make any specific reference to such tests and decided that AEC did not or would not acquire control of BCFP[453].

159. Such a finding might result in unknown consequences. It could signify that the criteria used in order to determine what materially affects the

449. *Id.*, pp. 69-70. See also A.A. BERLE, *supra*, note 134, [58 *Colum. L. Rev.*]; B. GIBSON, "The Sale of Control in Canadian Company Law", (1975-76) 10 *U.B.C.L.R.* 1.

450. *1978 Act*, *supra*, note 1, s. 99(a).

451. Such an argument is also found in the dissenting reasons of the OSC Chairman in *Dataline*, *supra*, note 433, 53C, where he said that a 34% holding was carrying with it an element of "power or authority to control". It seems therefore, despite the clear reasons given by the majority, that the uncertainty created by the *BCFP-Noranda-AEC(2)* reasons subsist among commissioners.

452. *BCFP-Noranda-AEC(2)*, *supra*, note 441, p. 13C.

453. *Id.*, p. 14C.

control of an issuer will apply to s. 99(a) as well. In this case, an ownership insufficient to run the corporation on a daily basis, but giving to its holder the power to block significant corporate transactions[454], would constitute control under s. 99(a), especially if no other shareholder, alone or acting in concert, is able to elect a majority of directors. If this reasoning is correct, the decision in AEC could be explained on the grounds that the 28% block obtained by AEC from Noranda was insufficient to impede the completion of significant corporate transactions.

On the other hand, the OSC might have used s. 1(1)(ll)(iii) in an attempt to discover whether the Noranda departure and replacement by a new shareholder was materially affecting the control group made up of Noranda and the two other major shareholders, one of them directing 26.052% and the other one 14.978% of BCFP's shares[455]. The fact that Noranda was leaving would have affected the control group, providing that they were acting in concert; but the evidence submitted was to the contrary.

160. Two facts must be noted in respect of both interpretations. In the first case, both would reduce the importance to be given to the finding that the purchaser might or might not be able to elect a majority of directors. As a result, *Policy 3–41* would be weaker and less useful than it is presently. Indeed, it would now be completely useless.

As noted above, the majority of the Commission in *Dataline* relied solely upon *Policy 3–41* and the test found therein. Although a dissenting opinion was expressed, it may be said that the uncertainty created by *BCFP-Noranda-AEC(2)* was temporary. In the second case, the difference of language between s. 1(1)(ll)(iii) and s. 99(a) must be stressed. The former speaks of control being materially affected while the latter uses the expression "power or authority to control the business or affairs". Both wordings seem to refer to different things. To materially affect the control could imply that its actual status or exercise may be altered by specific events. On the other hand, to control the business or affairs lies more in positive acts made pursuant to a sufficient ownership; in other words, whether the purchaser has acquired the power to run the business on a daily basis. If the OSC decides to apply s. 1(1)(ll)(iii) to requests made in reliance upon s. 99(a), the range of application of this section will be seriously restricted.

454. *Alboini, supra*, note 4, p. 507; as said above, the majority of the OSC implicitly dismissed that possibility, while the minority relied upon in *Dataline, supra*, note 433.

455. BCFP had three major shareholders; Noranda with 28%, Brunswick Pulp & Paper Co. with 26.052%, which was in turn equally controlled by Mead Corp. and Scott Paper Co. In addition, Mead owns directly 14.978% of BCFP. See *BCFP-Noranda-AEC(2), supra*, note 441, p. 8C.

161. The power to control the business and affairs of the offeree corporation would not be acquired if the purchaser was in an indirect control position before the private agreement took place. However, this indirect control, which is the control of a third company which in turn controls a subject company, must really be in the hands of the purchaser before the transaction is completed. In *Newsco*, the applicant owned about 23% of F.P. Publications, which in turn controlled Ronalds Federated through an ownership of 51.6%. The indirect control of Ronalds by Newsco was therefore around 11.6%. The applicant submitted that it had not acquired control of Ronalds through its agreement with F.P., an agreement whereby Newsco obtained the 51.6% holding of Ronalds. In such a case, it was evident to the Commission that Newsco was unable to control Ronalds prior to the agreement, but was able to do so afterwards[456].

A limited control would similarly be insufficient to deem the offeror as having acquired effective control of the offeree. Such might occur where several major shareholders each hold a significant ownership, none alone being sufficient to permit them to obtain a majority of directors. They are therefore unable to control the business of the offeree company. Where none of these major shareholders is acting in concert with another, and where none of them is allowed to increase its ownership as a condition of the agreement entered into, such limited control would not give the offeror effective control[457].

162. *The Draft Policy* provides an example in which an application pursuant to s. 99(a) could be granted. It is based upon the idea that the purchaser is seeking only a consolidation of its control block, being already

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456. "There is a world of difference in terms of 'the power or authority to control the business or affairs of the offeree company' in directly owning 51.6% of the common shares of that company, and between owning 22½% of a company that owns 51.6% of the company said to be controlled. That indirect control works out to 11.6%. While it is true that Newsco was one of a small group of shareholders that controlled F.P. and that F.P. controlled Ronalds, we do not think that put Newsco in a position such that it could be said that it had 'the power or authority to control the business or affairs of the offeree company' as that concept is stated in s. 99(a). It should be noted with respect to the question of control, that Policy Statement 3-41 indicates that 'substantial weight will be given as to whether the offeror will, as a consequence of the private agreement transactions, acquire the practical authority to nominate a majority of the Directors.'"
*Newsco, supra*, note 249, p. 309; *Turbo case, supra*, note 212, for another example of acquisition of indirect control. The difference is that Turbo was not a shareholder of either company before it purchased the control block. Compare to *McLaughlin, supra*, note 3, for direct control by insiders.

457. *BCFP-Noranda-AEC(2), supra*, note 441, pp. 12C to 14C; but see the dissenting opinion in *Dataline, supra*, note 433, even though the offerors had no director on the board.

in a control position. The purchase effected is therefore a mere acquisition of shares rather than an attempt to obtain control[458].

This illustration is curiously structured; it would allow a purchaser, who had obtained control without paying any premium[459], to consolidate his position by entering into agreements, to pay an excess premium and then to be granted an exemption under s. 99(a) for the reason that control was not acquired as a result of these latter agreements[460].

163. This example, although not reproduced in the *Policy*, was likely relied upon by McLaughlin when he applied for an exemption pursuant to s. 99(a). Through an agreement the applicant increased his holding from 52.895% to 57.92%[461]. As noted by the Commission, the result was to remove any possibility that McLaughlin might lose control to someone else[462], especially where the ownership was calculated on a fully diluted basis. While seeking an exemption from s. 91(1), the applicant stressed there was no sale of control, in as much as he already held such control[463].

This argument proved not to be persuasive, and the application was denied. The OSC was very clear; where an offeror already has control, an application to be relieved from the follow-up offer could only be based upon s. 99(e)[464]. The Commission underlined that nothing in the *1978 Act* said that s. 91(1) should not apply where an offeror had control[465], and added that

> [...] it would be absurd, or at least distorted interpretation of the language of clause (a) of section 99 to restrict its application only to bids by non-controlling offerors. Section 99 is, however, supplemental to section 91 and must be read in a manner which will give effect to the purpose and intent of section 91.[466]

164. The resulting effect of the decision in *McLaughlin* appears difficult to justify, especially in light of the *Dataline* case. In both instances, control was acquired and a premium paid to the controlling shareholders, the difference being that the equality of treatment was used only in *McLaughlin*. This may be explained by the fact that transactions carried out by both a controlling and insider shareholder, which may potentially affect

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458. *Draft Policy, supra*, note 344, p. 7.
459. *The Draft Policy* stressed that such should be the case where control was acquired through the stock exchange 5% rule, or by way of private agreement.
460. S. 99(a) of the *1978 Act* was understood as such; see *Control Block Transactions, supra*, note 90, p. IV-106.
461. Or, on a fully diluted basis, from 49.6% to 54.3%.
462. *McLaughlin, supra*, note 3, p. 99C; pp. 48-49.
463. *Id.*, pp. 103C-105C; pp. 52-54.
464. *Id.*, p. 105C; p. 54.
465. *Id.*, p. 106C; pp. 54-55.
466. *Ibid.*, p. 54.

the credibility of the marketplace or be abusive to other shareholders, should not be permitted, whether or not they are prohibited by the *1978 Act*. The *Interim Report* adequately questioned the inherent abuse of minority shareholders by an insider buying shares at a premium where control is not acquired[467]. It may be suggested that the abuse arose from the fact that through the purchase of shares, McLaughlin was securing absolute control over his company, thereby preventing other shareholders from selling their shares to a potential bidder. Put in a different way, had the takeover fever been nonexistant, the decision might have been different.

165. The OSC attempted to interpret s. 91(1) solely in light of equality of treatment, and did not look at the other main branch of the streams sustaining the follow-up offer[468], *i.e.* the acquisition of control. A private agreement under s. 88(2)(c) is a takeover bid of a special kind in the sense that a private acquisition of shares resulting in a holding of more than 20% for the purchaser does not automatically trigger the application of Part XIX of the *1978 Act*, as well as the equality of treatment found therein[469]. Such will be the case, through s. 91(1), if a 15% premium above the market price is paid. For non exempted takeover bids, Part XIX and the equality of treatment therein, such as s. 89(3) and s. 91(3), apply, but not s. 91(1). As noted above, s. 91(1) applies only to takeover bids exempted by s. 88(2)(c); a certain form of equality of treatment is therefore provided in either case. The major difference is that through s. 99(a), the non acquisition of control may relieve an offeror from making the follow-up offer. To pretend that a follow-up offer must be made in every instance where a 15% premium is paid, regardless of the control feature, implies that one of the branches referred to in the decision is set aside to the profit of the other one[470].

166. Strong criticisms of the *McLaughlin* decision are also found in the *Interim Report*, wherein it was reemphasized that s. 91(1) should only be triggered by an effective acquisition of control whether by one or successive transactions, control being understood as the ability to "exercise a controlling influence over the business and affairs of the offeree company"[471]. The *Interim Report* also clearly stated that s. 91(1) was not designed for the protection of minority shareholders from so-called abusive transactions by insiders.

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467. *Interim Report, supra*, note 16, p. 226A.

468. *McLaughlin, supra*, note 3, p. 104C; p. 53.

469. See *supra*, #70.

470. The argument by which the minority shareholders have to be given some protection where an insider makes a takeover bid does not sustain the position taken by the Commission. Although this seems an obvious statement, s. 91(1) was not the proper manner to provide them with the protection needed.

471. *Interim Report, supra*, note 16, p. 226A.

167. In any event, it may be said that McLaughlin was the victim of his reliance upon both the *Policy* and the *Draft*. The recent decision in *Dataline* gives one to understand that the same uncertainty surrounding the interpretation of the first category found in *Policy 3-41* has now reached s. 99(a). *McLaughlin* resulted in the application of s. 91(1) to insiders already in control contrary to any expectation. In *Dataline*, the majority, after having decided that control had not been acquired, granted the exemption while a dissenting opinion relied upon the notion of public interest to refuse it either under s. 99(a) or s. 99(e). *Dataline* appears to have been decided more in conformity with the twofold spirit of s. 91(1) than *McLaughlin* was. In the event that the minority opinion of *Dataline* is adopted in a succeeding case, the interpretation of both s. 91(1) and s. 99(a) would become much more restricted and, to a certain extent, meaningless, since the equality of treatment would become the sole criterium leading to a compulsory offer to remaining shareholders.

### 4.3. The exercise of discretion under s. 99(e)

168. Section 99(e) contains the most important discretionary power given to the OSC under Part XIX of the *1978 Act*. It allows the Commission, upon an application by an interested party, to relieve any person or company from the requirements of Part XIX where such "would not be prejudicial to the public interest"[472].

169. As said above, *Policy 3-41* was released to specify the criteria on which the OSC would rely in exercising its discretion. However, both the language and the interpretation of the *Policy* have resulted in a confusing situation. In short, the fact that the transaction does not fall within the first category is insufficient to justify an exemption. It must also be established that the deal is not prejudicial to the public interest. It was also noted that reliance upon the *Policy* could result in unexpected outcomes. Moreover, it is unclear whether the public interest concept may be countervailed by the application of the *Policy*. Indeed, *Policy 3-41* must be looked at very carefully before relying upon it when seeking an exemption from the follow-up offer.

#### 4.3.1. Cases where an exemption is unlikely to be granted: the first general category

170. In the *Draft* as well as in the *Policy*, the OSC has focused on three situations as militating against the granting of an exemption:

472. *1978 Act, supra*, note 1, s. 99(e).

(a) A sale of control where the result is clearly unfair or abusive to the remaining shareholders;

(b) The sale of control follows a public distribution of equity securities of the same corporation (whether newly issued or derived from the control block) in which it may reasonably be assumed that investors relied on continued involvement of the controlling shareholder in the corporation's affairs, and the sale of control occurs within, say, ten years after the public distribution; or

(c) The offeror proposes obtaining effective control at a premium through purchases from fewer than fifteen shareholders, none of whom individually has effective control, at a premium unavailable to the remaining shareholders.[473]

Indeed, the latter two are truly examples of situations in which an exemption would not be granted, while the first one stands as a general statement which stresses the result of any sale of control. It might be said that examples (b) and (c) are types of transactions whose result will be unfair or abusive to the remaining security holders. Although they emphasize specific circumstances, they are not, at least conceptually, different from example (a) because they also produce an unfair result in respect of remaining shareholders[474]. It can therefore be said that one general category of cases in which an exemption is unlikely to be granted is that involving transactions whose results are clearly unfair or abusive. Despite this finding, exemples (c) and (b) will still be looked at before example (a) is analyzed.

171. Example (c) has been named the institutional purchase transaction[475], and involves a deal whereby the offeror acquires the complete holding of several large holders, often institutions, none of whom have effective control. This purchase is made at a premium generally unavailable to the small remaining security holders[476]. This pattern of transaction has been viewed as detracting from the credibility of the marketplace, especially from the point of view of the small remaining shareholders, because they are

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473. *Policy 3-41, supra*, note 345, p. 178. See the comments found in the *Interim Report* pertaining to *Policy 3-41*, pp. 229A-230A. There is obviously a difference between example (c), speaking of the acquisition of control, and examples (a) and (b) which use the sale of control. The fact that s. 91(1) imposes a follow-up offer to the purchaser, rather than to the seller, was discussed above as well as in the *Interim Report*. To the explanations found therein, the concept of equality of treatment in takeover bid situations must be added, bearing in mind that most of the requirements of Part XIX of the *1978 Act* apply to the offeror.

474. The difference would be that the unfair or abusive result does not have to be established in cases (b) and (c). Only the conditions of application of both examples would be sufficient evidence that such deals are unfair or abusive.

475. See *Control Block Transactions, supra*, note 90, p. IV–102; see also *supra*, note 473.

476. *Ibid.*

not offered the same opportunity to sell their shares[477]. It has been suggested that an underlying reason for not granting an exemption in this case is that the private agreement entered into really constitutes a selective takeover bid tendered only to a specific group of shareholders, so that control may be obtained[478]. The result is obviously unfair and abusive to those remaining security holders, specifically under the actual market situation[479].

172. Example (b), as the Commission itself acknowledged, flows from the Minister's statement to the Standing Committee[480]. It attempts to provide a solution to problems raised by a specific type of transaction which commonly took place in the early seventies[481]. The transactions referred to in example (b) are based upon the theory

> [...] that the presence of the controlling partner has caused the public shareholders to invest, and that there is some special attribute which the "senior partner" has, which gives the company its attractive qualities. The provision is intended to reduce the situations where the controlling shareholder brings in the public, takes advantage of the benefits which the expanded share capital base provides, and then sells his control position at a premium while leaving behind his public "partners".[482]

The Commission's concern lies in the fact that the investors' investment expectations, often based upon the presence of a particular majority shareholder for a reasonable period of time, are disappointed. Combined with the sale of the control block at a premium unavailable to the public, it is not surprising that these transactions raised concerns in the Ontario marketplace[483].

The OSC has suggested that ten years be viewed as a reasonable period of time before which the controlling shareholder might sell his block without bringing the follow-up offer into play, but has emphasized that circumstances of particular cases would be taken into consideration as well[484]. It has also stressed that where the majority shareholder has acquired control of a public company through market purchases or a partial takeover[485], the time limit

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477. See *Draft Policy, supra*, note 344, p. 14.
478. *Control Block Transactions, supra*, note 90, p. IV–102; *Draft Policy, supra*, note 344, p. 14.
479. *Supra*, s. 3.3.3.
480. *Supra*, note 5.
481. *Control Block Transactions, supra*, note 90, p. IV–101.
482. *Id.*, pp. IV–101, 02.
483. See *Draft Policy, supra*, note 344, p. 13.
484. *Id.*, pp. 13-14. The latter statement was found in the final text of example (b) as set out in the *Draft*, but was omitted in the *Policy*. This, however, does not set aside a finding by the O.S.C. of particular facts tempering the ten year period.
485. This criterium will be used where the corporation is already public. The manner in which control is acquired before the company goes public is not considered.

alone would not be the only element relied upon in determining whether a transaction falls within example (b). Further analysis would be required in such a situation. The OSC stated that a public distribution of equity securities, following the acquisition but prior to the sale of control, in which it is reasonable to assume that investors had relied upon the continued presence of the same controller, would fall within example (b). Evidence to the effect that the majority shareholder had "significantly changed the objectives and the nature of the corporation would tend to support such reliance"[486] by investors[487].

173. The public distribution of equity securities is obviously the element which triggers the application of example (b). However, the most difficult finding to establish before example (b) is applicable is whether the presence of the majority shareholder was a major investment factor for public investors. It is indeed likely that the reliance upon this presence might not be of equal importance for each investor. It is unclear whether the sole reliance on the presence of the controller would be sufficient, whatever the weight of such reliance. The presence as well as the work performed by the majority shareholder[488] give the impression that the weight of the reliance is irrelevant; in fact, example (b) focuses on the controller and assumes that shareholders have invested because of him. On the other hand, the language used in the *Draft* may lead one to think that the ten year period and the reliance by investors are two different criteria, the second applying specifically where the corporation is already a public one. In the text of example (b) however, both criteria are linked by the preposition "and", which implies that both need to be established before the transaction would fall within example (b). It may be accurate to say that the *Draft Policy* intended to discuss the reasonable period first, and then the reliance where the public issue takes place, both criteria having to be found present in any transaction before falling within example (b).

#### 4.3.1.1. A sale of control unfair or abusive to the remaining shareholders

174. The most important type of transaction in which an exemption from the follow-up offer will be unlikely includes any transaction where the

486. *Draft Policy*, *supra*, note 344, p. 14.

487. In the final text of example (b), the distinction between the acquisition of a public company and a private one is not made, which may lead one to think that this criterium will apply to both and not only in those cases where public corporations acquired were already public.

488. The final text both in the *Draft* and in the *Policy* uses the expression "continued involvement of the controlling shareholder". There is however no change in the spirit of example (b).

result of the sale of control is clearly unfair or abusive to the remaining security holders. What constitutes a result which is clearly unfair or abusive is however far from determined.

175. *Policy 3–41* does not provide any definition or guidance in respect of what might be viewed as unfair or abusive. It could be said that any form of private agreement is inherently unfair to non-controlling shareholder[489]. However, the introduction of s. 91(1), the allowable premium and the *Policy* as a whole tend to demonstrate a contrary view. It was suggested that an outrageously[490] large premium, and situations where no real market exists in which public shareholders may sell their shares, while the majority shareholders can sell their complete holding, could be examples of abusive results[491].

176. The *Draft Policy* gives two specific examples which clearly originate from American case law on the sale of control. The *Draft* first stresses that the appropriation by the new controllers of corporate assets for their own benefit, instead of for shareholders generally, would fall within example (a). This statement is backed up by the fact that in the U.S., controlling shareholders and directors are subject to fiduciary duties when managing the affairs of their corporation. Where they take advantage of their position, or use others' property for their own benefit, they breach these fiduciary duties and are accountable to the corporation for the money received. What distinguishes the U.S. from the traditional common law as found in Canada and in the U.K. is that not only directors, but majority shareholders owe fiduciary duties. The Commission therefore clearly suggested that such a situation should apply in Canada as well. The Ontario remedy to the breach would however be different; instead of compelling majority shareholders to return the profit received, an equivalent offer should be made to remaining security holders[492] by the offeror.

177. The second example set out in the *Draft* is more specifically based on the U.S. case law. In decisions called looting cases, American courts have held controlling shareholders liable where it has been found that they had acquired corporations with the objective of looting them[493]. The OSC drew references to such situations by using the expression "[...] follow other policies to the same end which would reduce the profitability of the corporation"[494].

489. Since the decision in *McLaughlin* and the dissenting opinion in *Dataline*, this seems to be the opinion of at least some of the commissioners of the Commission.

490. See *Control Block Transactions, supra*, note 90, p. IV–101.

491. *Ibid.*

492. See *e.g.* N. LEECH, *supra*, note 119, p. 838; R.W. JENNINGS, *supra*, note 120, p. 29; A. HILL, *supra*, note 122, p. 1023; and see *supra*, #44.

493. *Supra*, #33.

494. *Draft Policy, supra*, note 344, p. 13.

What is surprising is not the reliance upon American law. It has been acknowledged that principles underlying legislation both in the U.S. as well as in Canada are similar and indeed, were drafted almost similarly[495]; it is rather the explanation put forward by the Commission in attempting to define more precisely which types of transactions would be unfair or abusive. The OSC said that

> [...] [w]hile corporate law provides remedies for such situations in practice they are expensive and difficult for a minority shareholder to pursue. The requirement for a follow-up offer should act as an additional control mechanism.[496]

The Commission recognized that the line drawn between corporate and securities law was no longer adequate. Corporate and common law were not the only ways to provide protection to minority shareholders: in fact, they were insufficient to adequately protect them in takeover situations. The OSC therefore expressed its disagreement with both the *Merger Study* and the *Kimber Report*[497] where it was said that securities regulation was not designed for such objectives, and that the evolution of the common law would be sufficient to provide minority shareholders with sufficient protection.

178. These two examples set out in the *Draft* were not referred to by the Commission in its decisions pursuant to s. 99(e). The OSC preferred, through its own case law, to set up elements to be used when determining what constitutes[498] an unfair or abusive result. However, the basic position put forth by the OSC has still been followed; since corporate and common law were insufficient to protect minority shareholders, the Commission therefore used its discretion to provide them with more efficient protection.

179. It must be borne in mind that once an exemption under s. 99(e) is sought, the Commission can take into account the entire background of the transaction[499] as well as the special facts[500] of each application in determining whether the exemption is to be granted. For instance, recent corporate history, transactions in the offeree's company securities and market liquidity may be criteria relied upon by the Commission in deciding whether the transaction is unfair or abusive[501].

495. See *supra*, note 159.
496. *Draft Policy*, *supra*, note 344, p. 13.
497. See *supra*, # 15 and # 19.
498. See *Newsco*, *supra*, note 249, p. 310.
499. *Id.*, p. 311; *Atco*, *supra*, note 158, pp. 419-20. See *supra*, # 138.
500. See *e.g.* *Newsco*, *supra*, note 249, p. 314.
501. *Id.*, pp. 311, 313; *Atco*, *supra*, note 158, p. 419.

180. The OSC has taken steps to stipulate more precisely the operational meaning of "unfair"[502] result in relation to the remaining security holders. It is incorrect, when determining what constitutes an unfair result, to concentrate on the size of the excess premium as being the most relevant factor[503]. However, where a takeover bid, made at a consideration substantially lower than the one in the agreement[504], has recently taken place, the Commission may conclude that a very small excess premium, when put in a real market context, is in fact a substantial one[505]. A small float of the offeree's shares and the resulting thinness of trading may lead the Commission to the same conclusion[506]. Indeed, the OSC has evaluated the importance of the premium not only with respect to the market price, but also in relation to the reality of the trading[507] of the offeree company's stock to determine whether the result is unfair to the remaining shareholders[508].

181. The two examples set out in the *Draft Policy* and discussed above were clearly left aside. Although these may indicate what is meant by an abusive transaction, it also seems clear that the OSC is not bound by the draft of one of its policies. However, the fact that the Commission used different factors in determining which transactions were unfair rather than applying those listed in the *Draft Policy* might have been indicative that the Commission had not yet reached a compromise on its reliance upon common law concepts in the application of Ontario securities law. In *Atco*, while reviewing the criteria used in *Newsco* to determine whether the transaction was unfair, the majority of the Commission noted that IU had acted upon what "[...] was best for it as the majority shareholder of CU and not on the basis of what was best for all of the CU shareholders including the minority"[509]. The majority of the Commission then added that the broad question concerning the type of duty owed by the majority towards the minority, as raised by the IU behavior was, in most instances, "[...] best left

502. In *Newsco*, the O.S.C. stressed that the transaction was unfair and it used criteria to determine so. In *Atco*, some of the same criteria were used, but this time, the O.S.C. decided that the transaction was neither unfair nor abusive. It is unclear whether both expressions carry different meanings and are designed to deal with different situations, or whether the O.S.C. sees no real difference between both wordings.

503. *Newsco, supra*, note 249, p. 311; *Atco, supra*, note 158, pp. 419-20. However, it may be one criterium relied upon. See *Atco, supra*, note 158, p. 422.

504. *Id.*, p. 312; *id.*, p. 421.

505. *Newsco, supra*, note 249, pp. 312-13. However, the fact that the offeree company's stock is heavily traded and widely held could countervail this fact. See *Atco, supra*, note 158, pp. 420-21.

506. *Newsco, supra*, note 249, p. 313.

507. *Ibid.*

508. *Ibid.* The exemption was denied as prejudicial to the public interest.

509. *Atco, supra*, note 158, p. 422.

to company law and to minority shareholders who may pursue their remedies in other forums" [510]. It seemed clear that the Commission was not the proper place to raise such an issue. Moreover, the majority indirectly said it would be willing to accept differences of treatment between both groups so long as they were not unfair or abusive to the remaining shareholders [511].

182. It is interesting that a different attitude was adopted in *Newsco*, especially where the OSC discussed the effects of the prior acquisition of Ronalds' shares by F.P. Publications. Even though a difference of 50% between the acquisition and resale prices could not be *per se* unfair to the remaining shareholders, the Commission noted however that it was

> [...] an important factor as to how the shareholders of Ronalds have been treated and it does reflect on the equitable treatment of shareholders in the capital market generally — a factor of which this Commission must take special cognizance.[512]

It is even more interesting to note that since then, the Commission has clearly emphasized the need for equality of treatment between majority and minority, most particularly in takeover situations. While stressing in several cases [513] that the Canadian common law had proven to be ineffective in protecting the minority, the OSC indicated that through its policies, declaration of principles and through specific sections of the *1978 Act*, it had resumed the task of so protecting them [514]. In this sense, it might be said that the spirit of the examples set out in the *Draft* was respected and brought back into operation by the Commission.

### 4.3.2. Exemptions of the second general category: the guidelines

183. As said above, guidelines have been suggested by which a purchaser would be entitled to seek an exemption pursuant to s. 99(e) even though the transaction fell within the first category. In these cases, the balance between the economic costs and the benefits of the follow-up offer is considered a more important factor than the equality of treatment [515].

184. All examples set out as guidelines are illustrative of techniques which will permit the purchaser of control to seek an exemption pursuant to

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510. *Ibid.*
511. *Ibid.*, last paragraph.
512. *Newsco, supra*, note 249, p. 312.
513. See *McLaughlin, supra*, note 3, *BCFP-Noranda-AEC(1), supra*, note 15; *BCFP-Noranda-AEC(2), supra*, note 441; *Torstar, supra*, note 8.
514. See *e.g., supra*, #67.
515. See, for a list of them, *Policy 3-41, supra*, note 345.

s. 99(e) even though the result may be unfair or abusive to the minority. In each of these cases [516], the majority may be allowed a premium where the minority will be deprived of the opportunity to share in such a premium.

185. More highly questionable than the view that these situations supersede the notion of public interest, is the fact that they override the first category of cases where an exemption will be denied because the result is unfair or abusive. It is difficult to see why the basic principle of equality of treatment should be set aside where specific corporate techniques are used by the majority shareholders to alter or modify the corporate life. It must be borne in mind that the aim of securities regulation is the protection of every investor participating in the marketplace. Such protection may be specially required to assure every participant that the credibility of the marketplace is not in jeopardy where these specific transactions are completed. This objective can hardly be said to be achieved where one realizes that the basic principles found in the legislation are simply set aside by the release of some guidelines under which the *Act* will apply.

186. It is even more difficult to see a thread among the guidelines. In example (a), (b) and (d), no form of equality of treatment is available to remaining security holders. However, examples (c) and particularly (e) are illustrative of some form of such an equality. In example (e) for instance [517], remaining shareholders are offered the opportunity to share in the premium where corporate techniques such as amalgamation, winding-up or arrangements are used. Moreover, where a squeeze-out results from an amalgamation, the Commission has stressed that other common law and OSC requirements will have to be observed. In such a context, it is interesting to note that the policies released by the Commission, which have to be followed in such cases, are designed to ensure fairness as well as equality of treatment between majority and minority shareholders. In example (e), flexibility is allowed in the manner in which the follow-up offer is made, but the offer must still be equivalent in value to the one paid under the agreement.

The reason for these differences is unknown ; the whole situation seems even more questionable where one looks at example (d) and realizes that it is designed for reorganizations. Why a form of equality of treatment is possible for certain corporate transactions but not for some others is also unknown.

187. It is interesting to note that some American courts ruled that controlling shareholders infringed upon their fiduciary duties in situations

516. See *infra*, # 188 and ff.

517. See *In the Matter of Hudson's Bay Oil and Gas Company Ltd. and Done Energy Limited*, *supra*, note 361.

similar to those found in example (e). Through corporate reorganizations [518], mergers [519] and other sophisticated techniques [520], control has often been acquired or secured by controlling shareholders at a premium unavailable to those remaining. This premium has usually been obtained through exchanging shares at a more favourable ratio for shares owned by controllers. Generally relying upon the breach of fiduciary duty by the majority, several transactions of this sort have been successfully challenged by shareholders who were not offered the same premium.

188. Example (a) is directed at the repatriation within Canada of a foreign owned corporation, and is the one most open to criticism. It is difficult to understand why shareholders from Ontario as well as those in a uniform act province would have to pay the costs of such a repatriation, while the foreign owner would be able to have all the economic advantages of the sale of control [521]. It is also very hard to understand on what principle the OSC relies to claim the power to determine a national economic policy. It is even harder to believe that the Commission is an appropriate forum for such a determination [522]. It must be kept in mind that provincial powers related to securities legislation are basically designed for the protection of investors within the limits of the province [523]. Even though these laws have been broadly interpreted, it is more than doubtful that investor protection might lead a provincial commission to set up and enforce what it considers to be of national economic interest. Such a duty lies more in a political process and is, in any event, outside the scope of a provincial authority.

Example (a) of the guidelines was relied upon by the majority in the *Atco* case as a supplementary argument justifying the granting of an exemption [524]. It did not however explain or identify in which circumstances example (a) could be used; it simply used it.

189. Example (b) of the guidelines may be used where control is transferred to employees or family members of the majority shareholders. The example starts from the premise that these potential purchasers may be

518. See *e.g. Southern Pacific Co. v. Bogert, supra*, note 113; *Securities and Exchange Commission v. Chenery Corp.*, 63 S. Ct. 454 (1943); 318 U.S. 80.

519. See *e.g. Manacher v. Reynolds*, 165A 2d 741 (C. Ch. Del., 1960); *Levy v. American Beverage Corp., supra*, note 108.

520. Merger and going private: *Berkowitz v. Power/Mate Corp.*, 342A 2d 566 (S.C.N.J., 1975); redemption and liquidation: *Zahn v. Transamericana Co.*, 162 F.2d 36.
*(10th Circ., 1947); recapitalization: Honigman v. Green Giant Co.*, 309 F. 2d 667 (8th Circ., 1962); cer. den. 372 U.S. 941 (1963).

521. See *Atco, supra*, note 158, p. 421.

522. *Control Block Transactions, supra*, note 90.

523. See *e.g. Lymburn v. Mayland*, [1932] A.C. 318 (P.C.).

524. *Atco, supra*, note 158, p. 423.

unable to finance a follow-up offer, and thus, if one was required, it might either discourage the controller from leaving or might force him to sell his block to an unwelcome party. Both results are viewed by the Commission as undesirable. The availability of an exemption in such circumstances might however be narrowed where it is established that the actual majority shareholder has used his position to induce a purchase of his control block and to keep the premium for himself: in other words, using example (b) to contravene the spirit of s. 91(1).

As noted[525], it is doubtful whether Ontario shareholders should bear the costs of an *unfair* or *abusive transaction* in order to provide the controller with a premium unavailable to others. In the actual market context, this example might also be used to secure absolute control within the family as a defensive measure against a potential takeover bid at the expense of the minority. Even though an underlying argument to example (b) is that a sale of control to employees or family members is a good thing[526], it seems unclear whether the resulting effect might be as good for both the company and other shareholders.

190. Example (d) deals with corporate reorganizations in which the control block is not sold, but rather is displaced from the original parent to one of the affiliate corporations once the reorganization is completed. This change in the holder of control is allowed where a *bona fide* corporate reorganization occurs.

The example arises from the premise that effective control has not been disposed of at the expense of minority shareholders, and that control is still held within the corporate group, even though a premium has been paid.

Example (d) is also subject to criticism, especially if it is compared to example (e). It is unclear why remaining shareholders should not be allowed to share the premium following a transfer of control, even though such control is still within the group. Although the reasons for the reorganization are based upon valid business purposes, there is no convincing explanation as to why the premium should not be shared, especially if the transfer results in an increase of the affiliate's holding in the parent company.

191. Examples (c) and (e) are cases where the remaining shareholders are not really abused, or where they knowingly waive their right to an equal opportunity. Example (c) may be relied upon where minority shareholders

525. See *Control Block Transactions, supra*, note 90, p. IV–103; it must however be noted that the original entrepreneur should be allowed to get a premium on the sale of his control block, bearing in mind that in these cases there is often no distinction between the life's enterprise and the company whose control block is owned by the entrepreneur. This would be an exemption to the equality of share principle.

526. See *Control Block Transactions, supra*, note 90, p. IV–103.

agree, after full disclosure and a two thirds vote, to forego their right under s. 91(1). It seems obvious that the Commission cannot compel security holders to receive something which they do not want, even though it considers the transaction unfair or abusive to them. The OSC's duty in such a case is to make sure that no one will receive other advantages when voting in favour of waiving the follow-up offer. The exclusion of such votes could permit the Commission to fulfill such a duty.

192. Example (e)[527] is designed to provide the offeror with relief from s. 91(1) where minority shareholders are offered a share in the premium through specific corporate transactions. Although the premium paid is different in mode, an equivalent offer has been made to remaining shareholders, which respects the principle underlying s. 91(1). The example is framed on the payment of a consideration at least equal to the greatest one paid in the agreement. Indeed, the offeror would have to establish that remaining shareholders would not be in a worse position than if they had been tendered a takeover bid[528] and that the consideration offered is equivalent.

Example (e) is designed to cover cases where the proposed transaction following the agreement would not technically qualify as an offer, but where equality of treatment is respected. As said above, there are some similarities between American cases and example (e). The only major difference is that example (e) will apply where a private agreement has been entered into prior to an amalgamation or liquidation, whereas in the U.S., the premium was paid through the amalgamation, merger or liquidation.

193. Both examples (c) and (e) follow a different logic from that underlying examples (a), (b) and (d), in the sense that they are truly cases where it is not prejudicial to the public interest to grant an exemption from s. 91(1). In both cases, remaining shareholders are offered an equal opportunity which they can either refuse or accept. Moreover, both examples would hardly fall within the first category of *Policy 3-41*. Indeed they follow the legislative objective which attempts to balance costs against benefits, but which also attempts to respect the equality of treatment among all shareholders.

194. The last example set forth in the guidelines is a case where the Commission feels that the offeror does not have to be put in a disadvantageous position. In example (f), the purchaser is forced to acquire the control block at a price determined by neither party to the agreement, the price of which may be higher than the market price calculated under the *Act*.

527. See *supra*, note 517.
528. See *Control Block Transactions*, *supra*, note 90, p. IV-104.

The Commission appears to think that under such circumstances, even though the result might be viewed as unfair to the remaining shareholders, it might be inappropriate to compel the purchaser to make a follow-up offer.

### 5. Conclusion

195. One of the first conclusions concerns the OSC's involvement in so-called corporate matters. It is obvious that there is no real distinction in Canada between securities and corporate law. Such a separation is found in the U.S. and is explained by constitutional reasons. For a long time, it has been observed that state corporate law was inadequately protecting shareholders. On the other hand, federal securities regulation has provided minority shareholders with new legal means, unavailable under state law. U.S. courts ruled that these means could not be used to challenge infringements upon common law, but were rather designed to enforce the federal legislation, which had superseded the old common law in many instances.

These considerations do not exist in Canada. The OSC, through its decisions in respect of takeover bids and follow-up offers, as well as through some of its policy statements, has clearly showed that it had intended to compensate for the inadequacies of the common law *vis-à-vis* minority shareholders.

196. This involvement follows the logic underlying securities legislation, which is primarily designed towards investor protection. *Protection* should be understood as maintaining a certain form of equality between majority and minority shareholders and should not be regarded as an objective beyond the scope of the duties assigned to the Commission. The protection of minority shareholders in the takeover bid context, or more precisely the equality of treatment among all shareholders in such situations, is simply one specific aspect of a more general task which the OSC has to perform. It is furthermore interesting to note that commentators, in articles dealing with shareholders' remedies in corporate law, have discussed the duty performed by the Commission and have concurred with its involvement in matters of minority protection.

197. The involvement of the OSC in corporate matters should however be looked at from two different viewpoints. The first is a limiting one; it should not be taken for granted that an increase in the Commission duties is the only manner to assure the credibility and the fairness of the Ontario marketplace. This means that the OSC does not have to intervene directly in every transaction whereby control is transferred.

The second viewpoint is an extending one; because it is doubtful whether controlling shareholders can self-regulate their behavior, the OSC is often viewed by investors and by the public as the only organism which can effectively protect their interests. The forcefulness with which applicants sought exemptions from the follow-up offer might confirm this view. Moreover, recent takeover fights in Ontario have clearly demonstrated that wealthy participants in the marketplace have attempted by every means possible not to respect the spirit of the securities act, but rather to achieve their objectives whatever the costs. Moral requirements, even though successfully applied in England, will be inadequate in North America.

198. The second conclusion deals more specifically with the existence of the follow-up offer. As was noted in the second chapter, to compel an offeror to make an equivalent offer to remaining shareholders where control is acquired from less than fifteen security holders is more a choice of policy and of philosophy of regulation than anything else. The objective of s. 91(1) is to prevent the sale of control at a premium where remaining shareholders are not offered the same opportunity. The underlying consideration of the takeover bid Part of the *1978 Act* is the equality of treatment for all holders of the same class of securities.

This legislative philosophy is not the only one possible; indeed, a different one was proposed by the majority of the Select Committee in 1973. The follow-up offer philosophy is neither right nor wrong; rather, it could be seen as suitable or less suitable. S. 91(1) should not be dropped because its application has proven to be difficult, or because Ontario is the only province where a follow-up is required; s. 91(1) should be deleted only if the philosophy of equality of treatment and fairness, which underlies Part XIX, is replaced by another one.

199. It is submitted that the key problem is less the existence of the follow-up offer *per se* than the manner it has been applied and interpreted since the enactment of the *1978 Act*. Actually, the OSC directly intervenes in the process of s. 91(1): it may decide whether the consideration is sufficient, whether the market price was accurate, to prohibit the use of certain exemptions, etc. These discretionary powers, thought to provide the Commission with the necessary flexibility, have transformed the principle of equality of treatment where control is sold into a highly judicial issue whose result is sometime unexpected. For instance, the release of policy guidelines which have narrowed the scope of application of the follow-up offer, and then the broad interpretation given to them by the OSC in its decisions have raised broad criticisms from participants in the marketplace. Put in a different way, is the principle underlying s. 91(1) applicable without such a strong involvement?

200. This is the key problem. If s. 88(2)(c) is deleted, then, the rule is the same for everyone, there is no need for discretion, but there is no

flexibility at all. On the other hand, if the *1978 Act* stays as it is now, there is flexibility, but also a strong judicial process to deal with. Even though the answer is again more a choice of policy than the solution of a strict legal question, a more discrete involvement from the Commission would be viewed as desirable. The credibility of the marketplace together with the protection of investors can be properly achieved without a continuous and direct intervention of the regulators.

201. A last conclusion deals more specifically with the use of policies by the Commission. *Policy 3-41* and its subsequent application showed that the Commission has gone too far, and that it has been caught for having considered policies as legal, binding requirements. It is not submitted that the OSC should not be given large discretionary powers; but that the policy statements should no longer be viewed as carrying the same binding force as regulations or statutes. The non-compliance with policies ought not to be viewed as an "automatic" violation of the spirit of the *Act*, or as a behavior prejudicial to the public interest. If this is the Commission's intention, it should be given powers to make regulations and to enforce them. On the other hand, the release of policy guidelines ought not to be considered by practitioners as being more than indications of the manner in which the OSC is willing to exercise its discretion.