THE VALUATION LAW REVIEW

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Corporate / Securities Decisions and Regulatory Developments

The Valuation Law Review summarizes corporate and securities decisions and recent regulatory developments of interest to business valuators and is a joint publication of The Canadian Institute of Chartered Business Valuators and Stikeman Elliott LLP. The Valuation Law Review is not intended to provide legal advice and readers should not act on information in the publication without seeking particular advice on matters that are of concern to them. Readers are cautioned against relying upon the decision abstracts contained herein, which are edited and in outline form only, and are directed to the full report of the reasons of the Court or Securities Regulator, as applicable.

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(2004), SCC 68
Supreme Court of Canada
October 29, 2004
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September 30, 2004
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I. CANADIAN CASES

Peoples Department Stores Inc. (Trustee of) v. Wise

(2004), SCC 68

Supreme Court of Canada

October 29, 2004

In the Peoples v. Wise decision, the Supreme Court of Canada makes certain pronouncements with respect to the correct interpretation of directors' and officers' duties to corporations and their stakeholders. Specifically, the Court holds that the statutory fiduciary duty under the Canada Business Corporations Act does not create a duty with respect to the interests of creditors as such, even in near insolvency situations. Rather, at all times, directors are required to act with a view to creating a "better" corporation, and "not to favour the interests of any one group of stakeholders". However, the Court indicates that dissatisfied creditors have two other avenues of redress available to them within the bounds of the Canada Business Corporations Act, the statutory duty of care and the oppression remedy. However, these avenues are tempered somewhat by the Supreme Court's strong affirmation of the business judgment rule, which discourages second-guessing of directors' good-faith business decisions.

In the *Peoples v. Wise* decision, the Supreme Court of Canada makes certain pronouncements with respect to the correct interpretation of directors' and officers' duties to corporations and their stakeholders, particularly creditors. The Supreme Court holds that the fiduciary duty of directors and officers under Subsection 122(1)(a) of the *Canada Business Corporations Act* (CBCA) (and presumably under its provincial equivalents) does not create a duty with respect to the interests of creditors as such, even in near insolvency situations. Rather, whether a corporation is solvent or insolvent, directors are required to act with a view to creating a "better" corporation, and "not to favour the interests of any one group of stakeholders". The Supreme Court goes on to say that dissatisfied creditors have two other avenues of redress within the bounds of the CBCA, in the form of the oppression remedy and the statutory duty of care set out in Subsection 122(1)(b) of the CBCA. These avenues are tempered somewhat, however, by the Supreme Court's strong affirmation of the business judgment rule, which discourages courts from second-guessing directors' good-faith business decisions. As certain aspects of the decision are less than ideal in terms of guidance, the decision is sure to be controversial and its true effect will only become clear as the decision begins to be interpreted and applied in the lower courts.

For present purposes, the facts of the case can be boiled down as follows. In 1992, Wise Stores, a Montreal department store chain controlled by the three sons of its founder, purchased Peoples Department Stores, another Quebec-based retailer, from the Canadian subsidiary of Marks & Spencer plc, which was then divesting itself of its Canadian retail operations. The $27m deal was fully leveraged. Wise Stores borrowed the $5m down payment and agreed to an eight year payment schedule with respect to $22m balance owed to M&S.

One condition of the deal – which turned out to be very important – was that Peoples and Wise Stores remain separate entities during the repayment period. The deal accordingly barred the Wise brothers from merging the two companies and prohibited financial assistance from Peoples to Wise Stores. This enforced separation made sense from the point of view of M&S, but in practice it seriously undermined the synergies that the Wise brothers had been counting on. In 1993, they went ahead and implemented a joint procurement policy under which Peoples

would do all the buying from North American suppliers and Wise from everywhere else. Because North American suppliers supplied 80% of the two companies' merchandise, this policy amounted to the extension of a substantial trade credit from Peoples to Wise.

When M&S got wind of the arrangement, it asked the Wise brothers to discontinue it. Eventually the Wise brothers agreed, but before long the two chains were in bankruptcy anyway. Their assets were sufficient to satisfy most creditors, but the trade creditors were left out in the cold. The Trustee of Peoples filed a petition arguing that the policy had favoured the interests of Wise Stores over Peoples to the detriment of Peoples' creditors. The legal basis of this claim was the directors' and officers' duty under Subsection 122(1) of the CBCA to act in the best interests of the corporation. That section states:

> 122. (1) Duty of care of directors and officers - Every director and officer of a corporation in exercising their powers and discharging their duties shall:
>
> (a) act honestly and in good faith with a view to the best interests of the corporation; and
>
> (b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

The primary issue at trial was whether the Trustee (as the representative of the creditors' interests) could recover from the directors of Peoples, namely the Wise brothers. In a 1998 decision, a judge of the Quebec trial court held that they could, on the basis that, on the brink of insolvency, a company's interests can increasingly be identified with those of its creditors (i.e. because the shareholders' equity interest is a moot point when everything that a corporation has, and more, is owed to creditors). The trial judge held that the directors' duty to Peoples under Subsection 122(1) was therefore, for all intents and purposes, a duty to the creditors. He held that that duty had indeed been breached and found the Wise brothers liable for $4.44m in damages.

The Quebec Court of Appeal reversed this decision in 2003, and the Supreme Court has now upheld the reversal, although largely on the basis of its own interpretation of Subsection 122(1) of the CBCA.

In the course of its decision, the Supreme Court highlights the distinction between clauses (a) and (b) of Subsection 122(1) of the CBCA, noting that Subsection 122(1)(a) constitutes a "statutory fiduciary duty" which is owed to the corporation itself, as opposed to the interests of any one group of stakeholders. As such, the Supreme Court refuses to turn clause (a) into a duty to shareholders, or to creditors in situations of near insolvency, by declaring (as previous jurisprudence sometimes had) that a corporation is really just its shareholders or (on the brink of insolvency, at least) its creditors. Explicit in the ruling is a further rejection of the trial judge's notion that directors' duties shift as the corporation's fortunes rise or decline. Rather, the Supreme Court holds that a director's duty under clause (a) of Subsection 122(1) is always the betterment of the corporation irrespective of the financial condition of the corporation. Moreover, it is a fiduciary duty in the fullest sense – i.e. a selfless responsibility from which the director cannot attempt to turn to his or her personal advantage in any way (reasonable compensation and incidental gains, such as appreciation of director-owned shares, are fine). Interestingly, the Supreme Court provides very little guidance in terms of how, from a practical standpoint, directors are to discharge their duties, other than to say that it may be legitimate for directors to consider the interests of a broad group of stakeholders.

The Supreme Court justified its determination that dissatisfied creditors have no recourse under clause (a) of Subsection 122(1) at least partly on the ground that the CBCA (like similar provincial statutes) provides two other avenues for dissatisfied creditors: the oppression remedy (Section 241) and clause (b) of Subsection 122(1), which the Supreme Court called the "statutory duty of care".

That creditors can advance oppression claims is far from a novel idea, but, given the discretionary nature of the remedy, the strong direction provided by the Supreme Court here may tip the balance in many future cases in favour of allowing such claims to proceed and succeed. The Supreme Court noted, in particular, that the creditor's credibility as an oppression claimant was greater in near-insolvency situations, although there is no indication that it is limited to such situations.

The Supreme Court's analysis of clause (b) of Subsection 122(1) – the statutory duty of care – is also significant. Contrary to some previous interpretations, the Supreme Court held that duties of directors and officers in a given situation are to be judged objectively. That is, the duty of care is to be judged on the basis of what the director or officer in question ought reasonably to have known, rather than on the basis of his or her actual subjective knowledge. While this means the lack of

experience of a director will not serve to lower the standard of care, it also arguably suggests that the duty of care might be relaxed somewhat for directors who possess special skills or expertise. If correct, this latter interpretation would be inconsistent with recent caselaw emerging out of the Delaware courts. (See, in particular, the decision of the Delaware Court of Chancery in the Emerging Communications, Inc. Shareholders Litigation summarized later in this edition of *The Valuation Law Review*.)

Furthermore, there is no suggestion in clause (b) that the duty is owed only to particular classes of persons. While giving little indication of how broadly the duty might extend, the Supreme Court holds it to be "obvious" that it extends at least to creditors, raising the question as to whether the duty of care is available to other stakeholders impacted by the conduct of directors as well. The nature of the duty owed to creditors (or other stakeholders) as such, is not clear, however. The Supreme Court refers in its reasons only to the duty of acting "diligently", "prudently", and on "a reasonably informed basis" with respect (it seems) to the interests of the corporation. There is no discussion of what duty of care, if any, is owed to the creditor or other stakeholder with respect to any special interests that it might have. Strictly speaking, therefore, it would seem that creditors have the right to sue under clause (b) to the extent that the directors' or officers' failure to act diligently to promote the corporation's interests might have harmed the creditor. Only time will tell whether the decision will be interpreted more liberally than that.

The Supreme Court adds even more protection for directors, however, in strongly affirming the applicability in Canada of the "business judgment rule". In doing so, the Supreme Court has given its stamp of approval to the growing practice of deferring to the good faith "business judgment" of corporate boards. The decision is full of observations to the effect that directors and officers possess "business sense" that the courts do not, that many ultimately unsuccessful business decisions are "reasonable and defensible at the time they are made" and that "perfection is not demanded". These will undoubtedly be frequently quoted in the future by directors' and officers' counsel.

The Trustee's argument was confined to Subsection 122(1) and it appears that the oppression remedy was not pleaded because it was the Trustee, rather than the creditors themselves, who brought the action. As the Supreme Court's analysis of clause (a) precluded any hope of recovery on fiduciary grounds, the Trustee's only remaining hope was clause (b). On the basis of a review of the evidence presented

at trial, however, the Supreme Court found that the Wise brothers had acted in good faith and with the best interests of the companies in mind in implementing the procurement policy. While at trial the issue of whether they might have acted so as to favour Wise Stores over Peoples was central, the Supreme Court seems to have held that the two businesses were effectively one. It also appears to have been moved by the fact that many external economic factors had contributed to the failure of the businesses, making it difficult for the Trustee to prove that the procurement policy itself had been responsible for the creditors' losses.

An unrelated ground of appeal is also of interest. The Trustee argued that the inventory transfers between Peoples and Wise Stores, having occurred within the year prior to the event of bankruptcy, should be reviewed under Section 100 of the Bankruptcy and Insolvency Act. The Supreme Court agreed that they were potentially reviewable, but went on to observe that a judge's powers under the section are discretionary and need not be exercised even where a transaction at "conspicuously greater or less than fair market value" (the standard set out in the section) has been proven. In this case, however, there was no need to consider whether to exercise discretion: the 6% discrepancy between the FMV of the inventory and the amount paid to Peoples by Wise Stores was not "conspicuous" enough to bring Section 100 into consideration. In addition, the Supreme Court held that the whole series of inventory transfers had to be considered, not just the single transfer referred to by the Trustee.

On a related point, the Supreme Court found that the provision in Section 100 that judgment can be given, not only against parties to the impugned transfer, but to non-parties who were "privy" to the transfer, applies to the Wise brothers. As the Supreme Court noted, the Wise brothers were in a position to "receive indirect benefits to the detriment of a bankrupt's unsatisfied creditors" as the result of the transaction. The Supreme Court therefore disagreed with the more conservative (and implausible) view of the Quebec Court of Appeal on the point, which was moot in any case, given the finding of non-conspicuousness.

Awad v. Dover Investments Ltd.

(2004), Unreported O.J. No. 3847

Ontario Superior Court of Justice

September 21, 2004

This decision of Mr. Justice Spence establishes that a party to a contractual joint venture with a corporation may, in certain circumstances, be defined as a "creditor" of that corporation and thus be an eligible complainant for purposes of an oppression remedy (in this case, under the *Ontario Business Corporations Act*) (the OBCA). The ruling provides another route by which duties of fairness can be introduced into a contractual joint venture situation. Because this may happen unwittingly, it is important for joint venturers to be aware of the possibility. Although, as discussed below, this original judgement was set aside by the Court on the basis of additional evidence admitted following the initial hearing, this decision nonetheless provides useful guidance on the availability of oppression claims in the joint venture context.

In the Awad v. Dover Investments Ltd. decision, the Ontario Superior Court holds that a party to a contractual joint venture with a corporation may, in certain circumstances, be considered a "creditor" of that corporation with standing to bring an oppression action. In this case, the key to the analysis was whether the claimant could show that a distribution from the joint venture had become indisputably due and payable.

The parties were in the oil and gas business. The Egyptian properties in question had been divided between two distinct joint ventures: REU and EWA. Awad held a minority interest in both. Dover Investments effectively controlled both joint ventures, but in the case of EWA, the shares that it controlled were registered in the name of Salna, its sole shareholder, director and officer, and a subsidiary company. Thus the parties to the two joint venture contracts weren't the same.

A dispute arose between Awad and Dover when Awad allegedly failed to make a capital call and to live up to certain other obligations under the EWA agreement. In apparent retaliation, Dover, which controlled REU's financing operations, refused to make profit distributions owing to Awad under the REU contract. Awad alleged oppression against Dover.

The issues in the case were the applicability of the oppression remedy and the availability of the doctrine of set-off.

Subsection 248(2) of the OBCA provides that oppression can be found where an action has been "oppressive or unfairly prejudicial to or … unfairly disregards the interests of a securityholder, creditor, director or officer of the corporation". Awad argued that, in light of Dover's failure to pay him, he was a creditor. As Justice Spence recognized, this raised difficult questions about the meaning of "creditor" for purposes of Section 248 of the OBCA.

Specifically, the question was whether, in order to be a "creditor" for the purposes of the oppression provision, there must be an actual existing debt or at least a right to liquidated damages. As Justice Spence noted, it would be possible, in the loosest sense, to define "creditor" more expansively, so as to include anyone involved in a commercial relationship with a corporation, such as a joint venture, in which there was an expectation of distributions by the corporation. Justice Spence rejected this analysis, at least where the distributions were to be from profits, on the ground that there was no certainty of profit. This type of contractual joint venture relationship is properly analyzed, he held, as an investment relationship, not a debtor-creditor relationship. Justice Spence concluded:

> "On this analysis a joint venture participation of the kind made by Mr. Awad is not enough by itself to constitute Mr. Awad a creditor of Dover. If Awad were a common shareholder of Dover, he would be regarded as an investor and not as a creditor unless and until a dividend or other distribution had become due to him by reason of its having properly been declared payable. Similarly it may be argued, in the case of the joint venture, that Awad cannot be regarded a creditor unless and until a distribution of profit has become due and payable to him and then only to the extent of the amount so payable and only until the amount is paid."

Justice Spence held, firstly, that the ordinary common-law meaning of "creditor" does not include those with a claim to unliquidated damages, and secondly, that "there is no apparent need for any … extended meaning to be given to the term 'creditor' in s. 248".

Awad therefore had to show that a distribution had indisputably become due and payable to him at the time he made his complaint. It would not be sufficient to show that he had a right to future profits if there ever happened to be any, or that he had a claim against Dover that might later render him a judgment creditor, if all went well in a trial of the issues. Fortunately for Awad, the Joint Venture Agreement was clear: it imposed an obligation on Dover to make monthly payments to Awad equal to his share (18%) of the net profits of the Joint Venture. These payments were owed to Awad but had been withheld.

But even this would not make Awad a creditor if Dover's set-off claim was alleged. Dover claimed that there was an established practice in the oil and gas industry of using set-off as a self-help remedy. Justice Spence held that this applies to current account and transaction set-off but not in the current circumstances, particularly

given the fact that the parties to the two joint ventures were different. Generally speaking, the transactions lacked the mutuality required for legal set-off and the close connection required for equitable set-off.

Given that Awad was a proper complainant, it was obvious that he had been oppressed as a creditor of Dover: the company had plainly used its controlling position in REU for the improper purpose of helping its shareholder and affiliate to avoid losses in relation to their holdings in EWA. Dover was ordered to pay out the distributions, and because its sole shareholder, Salna, had personally benefited from the withholding, he was held liable for a portion of the moneys owing.

Interestingly, on February 3, 2005, the Court issued supplemental reasons in this decision which effectively set aside the conclusion on the oppression application pending a new trial. Additional evidence was presented that showed that prior to the initial application, Awad had transferred substantially all of his assets to third parties in an effort to make himself judgement proof and avoid any claim Dover may have had to the capital call under the EWA agreement. Based on the new evidence, the Court felt that there was an issue as to whether, contrary to what was decided at trial, Awad had a reasonable expectation that Dover would deduct the EWA capital call from the REU distributions. The reasoning was that, since Awad was judgement proof, the REU distributions were Dover's only source of funds from which to recover the EWA expenses.

This conclusion does not alter the Court's ruling on the set-off issue or that Awad was a creditor of Dover and a proper party for an oppression claim. Rather, the issue becomes whether Awad's oppression claim has merit based on his reasonable expectations. As a result of the new evidence, Justice Spence ordered a trial to determine that issue.

Casurina Limited Partnership v. Rio Algom Limited

(2004) S.C.C.A. No. 105

Supreme Court of Canada

September 30, 2004

In this update from the August 2004 edition of The Valuation Law Review, we report upon the dismissal by the Supreme Court of Canada of an appeal brought by holders of convertible debentures of Rio Algom Limited seeking relief from oppression claimed to have been suffered in the context of the acquisition of Rio Algom by Billiton plc. In the lower court decisions, the debentureholders' claim was rejected on the basis of a term in the trust indenture that restricted their claims to those specifically set out in the indenture.

In the August 2004 issue of *The Valuation Law Review* (Volume 10, Issue 1), we reported upon the Ontario Court of Appeal decision in *Casurina Limited Partnership v. Rio Algom Limited*. Casurina, a holder of convertible debentures of Rio Algom, had appealed the trial judge's decision that it was not entitled to relief from oppression by Rio Algom. The claim arose out of the acquisition of Rio Algom by Billiton plc., following which Rio Algom's shares were de-listed from the Toronto Stock Exchange. This resulted in a significant reduction in the value of the debentures' conversion feature and Casurina argued that the absence of compensation for this loss amounted to oppressive conduct on the part of Rio Algom. Both the trial judge and the Court of Appeal rejected Casurina's argument, primarily on the basis of a term in the trust indenture governing the debentures, which said that the remedies available to debentureholders were limited to those that the indenture specified. After publishing our August 2004 issue, Casurina appealed the decision to the Supreme Court of Canada and on September 30, 2004, the Supreme Court dismissed the appeal without providing written reasons.

II. U.S. CASES

Hollinger Inc. v. Hollinger International Inc.

(2004), C.A. No. 543-N

Court of Chancery, State of Delaware

July 29, 2004

In another entertaining decision in the Hollinger saga, the Delaware Chancery Court ruled that the shareholders of Hollinger Inc. had no right to vote on the sale of The Daily Telegraph, as the sale did not involve "substantially all" of the assets of Hollinger International. The Court also rejected Conrad Black's argument based on principles of equity that a controlling shareholder can effectively usurp the decision-making power of the board members it has the power to elect.

In the last edition of *The Valuation Law Review*, we reported upon the Delaware Court of Chancery's decision on the fiduciary and contractual responsibilities of Conrad Black, as well as the statutory and equitable limitations with respect to stockholder-adopted by-laws and the permissibility of a rights plan to prohibit the stockholders of a corporation's controlling shareholder from selling the controlling shareholder to a third party. In that decision, the Court concluded that Conrad Black breached his fiduciary and contractual duties and acted without restraint. On this occasion, Hollinger Inc. (Inc.), the company which Black controlled, was back before Vice Chancellor Strine as it sought an injunction preventing Hollinger International Inc. (International) from selling the *Telegraph* Group to the Barclay brothers.

Inc.'s main argument was that International's shareholders had a right to vote on the sale because it involved "substantially all" of the assets of International. (As a practical matter, Inc.'s vote would have been the only one that mattered because although it owned only 18% of International's total equity, it controlled 68% of International's voting power through multiple-voting Class B shares). Inc. also presented an equitable claim that Inc.'s nominees on the board were unfairly excluded from voting on the sale. International countered firstly that the sale did not fall within the definition of "substantially all" under Section 271 of the *Delaware General Corporation Law* (DGCL); secondly, that the assets in question were ultimately not those of International but rather those of a sixth tier U.K. subsidiary (i.e. a corporate veil argument); and thirdly, the circumstances of the case did not create an equitable right to vote on the sale because Inc. was intimately involved in the acts giving rise to the "legal inhibitions" affecting the board.

In another entertaining judgment, the Delaware Court of Chancery dismissed all of Inc.'s arguments. The Vice Chancellor declined to rule on the veil-piercing argument, interesting as it was, as he did not want to offer any "definitive announcement" on this complex area of the law given the limited time he had to consider the other issues raised by this request for an injunction. He did suggest,

however, that a ruling in favour of International on this issue would, as a practical matter, render Section 271 "an illusory check on unilateral board power at most public companies".

Section 271 of the DGCL authorizes a board of directors of a Delaware corporation to sell "all or substantially all of its property and assets, including goodwill and corporate franchises" only with the approval of a stockholder vote. Vice Chancellor Strine defined "substantially all" in Section 271 of the DGCL to mean "essentially everything" and explicitly rejected the old view that it only meant significantly more than half of a corporation's assets. He applied the test articulated in *Gimbel v. Signal Cos., Inc.* which entails both a quantitative and qualitative test to determine whether a particular sale of assets involves substantially all the corporation's assets. The test that *Gimbel* articulated requires a stockholder vote if the assets to be sold "are quantitatively vital to the operation of the corporation" and "substantially affect the existence and purpose of the corporation".

In the context of the quantitative test, a detailed financial analysis indicated that the assets of the Chicago Group of newspapers were at least as big in size and as profitable as those of the *Telegraph* Group. The financial picture that emerged was one of "rough equality between the two Groups, with any edge tilting in the Chicago Group's direction". The Court also found that the sale of the *Telegraph* Group would still leave International with significant assets capable of generating substantial cash flow. In the year 2003, the *Telegraph* Group produced over $57 million in EBITDA, but the Chicago Group, by comparison, won the race and its $79 million in EBITDA was the largest contribution made by any of International's four operating groups. Accordingly, the Vice Chancellor held that the *Telegraph* Group was not vital to International's operations. In fact, the Vice Chancellor felt that neither the *Telegraph* Group nor the Chicago Group were quantitatively vital to International in the *Gimbel* sense, as the corporation could continue as a profitable entity without either one of them. As a result, it was held that the sale of the T*elegraph* Group failed to meet the quantitative component of the *Gimbel* test.

Before beginning his qualitative analysis, the Vice Chancellor noted that the relationship between the qualitative element of the *Gimbel* test and the quantitative element of the test is unclear. In particular, he questioned how assets to be sold can "substantially affect the existence and purpose of" the corporation within the meaning of *Gimbel* if they are not quantitatively vital to the corporation. He then suggested that the *Gimbel* test may simply involve a look at quantitative and

qualitative considerations in order to come up with the answer to the single statutory question, which is whether a sale involves substantially all of a corporation's assets. However, rather than continuing to explore the relationship between these factors, the Vice Chancellor proceeded with his analysis of the qualitative importance of the *Telegraph* Group to International. In this regard, the Vice Chancellor noted that the focus of this inquiry was on economic quality and the question to be asked was whether the sale would leave the stockholders with something that in economic terms was qualitatively different afterwards. The Vice Chancellor concluded that the sale did not strike at the heart and soul of International and was no different from the earlier sale of Canadian newspapers by International to Canwest, which did not require a stockholder vote. Value is what you look at – not, in Justice Strine's phrase, "how cool it would be to be the Telegraph's publisher". It was necessary, therefore, to look at the reasonable economic expectations of investors generally, not the social aspirations of a limited number of stockholders – such as Lord and Lady Black – who get to have dinner with the Queen as a result of their shareholdings.

On the equitable argument, the Court noted the reality that controlling stockholders have no right to usurp the authority of boards of directors that they elect, and the fact that just because such stockholders control the majority of the voting power does not mean that such stockholders must be given a veto over board decisions when such a veto would not also be afforded to dispersed shareholders who collectively own a majority of the votes. Rather, a controlling stockholder must live with the informed and good faith business decisions of the board of directors unless the governing corporate statute requires a vote.

The Court then set out in some detail the process by which the decision to sell the *Telegraph* Group was reached. International's Corporate Review Committee (CRC) worked closely with Lazard, their advisors, over a period of several months to consider the various options open to International, and Lazard from December 2003 onwards developed marketing materials, assessed key risks and publicized International's interest in receiving bids from potential bidders for both the Chicago and *Telegraph* Groups. 16 bids were received for the former and 11 for the latter over two rounds of bidding.

Lazard advised the CRC that the Barclays bid was not only the highest, but offered better contractual terms and the Barclay brothers were more experienced in the newspaper industry than the other bidders. Significantly, the $1.2 billion purchase price involved a multiple of 13.6 times the *Telegraph's* estimated EBITDA for 2004

which, Vice Chancellor Strine noted, was significantly higher than the multiple of 10 times which Inc.'s own COO, Peter White, testified was a reasonable one for the assets. The CRC also considered various tax issues and were influenced in their recommendation to sell the *Telegraph* Group by the fact that its retention by International and its continued operation in the competitive London newspaper market would have required a $185 million capital investment.

The Vice Chancellor therefore rejected the equity argument: Inc. could not be allowed to veto the good faith business decisions of the International board, whose decisions, the judge said, showed "good faith and rationality" in their detailed analysis of the sale of the *Telegraph* Group. Contrary to Inc.'s protestations that the CRC rushed the whole process and failed to consider reasonable opportunities to sell the whole company or do nothing, the evidence revealed that the CRC and its advisers "performed an aggressive market canvass that was rationally designed to elicit favourable bids for the entire company and for its various components". Vice Chancellor Strine said it was obviously open for individuals to disagree with the choice the CRC made, but it could not be fairly said that the CRC did not undertake "a rational decision-making process or consider relevant information". Taken as a whole, the information was inconsistent with Inc.'s claim of gross negligence on the part of the board of International Directors, Inc. was hoisted by its own petard as, after all, it helped to put in place the board in the first instance and therefore the exclusion of its nominees from the decision-making was largely a result of its own acts.

Orman v. Cullman
(2004), C.A. No. 18039
Court of Chancery, State of Delaware
October 20, 2004

The Orman v. Cullman decision is the latest in a series of Delaware cases on deal protection measures in public company mergers and acquisitions. Here, the Court rejected the plaintiff's argument that a lock-up agreement entered into by the controlling shareholder of the target company failed the Unocal test used to assess its legality. In dismissing the claim, the Court noted that the

The *Orman v. Cullman* decision speaks to the type of "deal protection measures" that an acquiring company can obtain from a controlling shareholder in the context of an M&A transaction. In the December, 2003 edition of *The Valuation Law Review* (Volume 9, Issue 3), we reported upon the decision of *Omnicare Inc. v. NCS Healthcare Inc.* in which the Delaware Supreme Court held that an irrevocable lock-up agreement with a majority shareholder combined with a "force-the-vote" provision was coercive, in the absence of a fiduciary out provision. In this more recent case, the Delaware Court of Chancery distinguished *Omnicare* and concluded that the public shareholders of a tobacco company, General Cigar

Holdings, Inc. (General Cigar), were not coerced to vote for a merger with another tobacco company, Swedish Match AG (Swedish Match), because of a lock-up provision for 18 months required by Swedish Match as part of the transaction.

Members of the Cullman family were the controlling shareholders of General Cigar. Swedish Match did not acquire control of General Cigar, as it wanted the Cullmans to continue managing the company after the transaction. Rather, the deal structure involved the sale of approximately one-third of the Cullman's interest in General Cigar to Swedish Match followed by a merger into a Swedish Match subsidiary. Following the merger, 64% of General Cigar's equity would be owned by Swedish Match and 36% by the Cullmans; however, the Cullmans would remain in control of the company as they held multiple-voting Class B stock. Although Swedish Match was offering a significant premium above the market price for securities of General Cigar, Orman sued the General Cigar board of directors for breach of their fiduciary duties in negotiating the merger terms.

As part of the merger negotiations, Swedish Match required that the Cullmans enter into a voting agreement under which they agreed not to sell their shares, and to vote their shares against any alternative acquisition proposal, for a specified period (initially 12 months) following any termination of the merger between Swedish Match and General Cigar. The idea was to protect Swedish Match from the risk that the Cullmans or General Cigar would "shop" Swedish Match's offer to other potential bidders. This protection was particularly important because the merger agreement did not contain a termination fee or expense reimbursement provisions. After some protracted negotiations and in exchange for a slightly higher offer, Swedish Match required the Cullmans to increase the restricted period under the voting agreement from 12 to 18 months.

Crucially, however, the Cullmans were bound only in their capacities as shareholders and nothing in the voting agreement limited their actions as directors or officers of General Cigar. As Chancellor Chandler remarked, the Cullmans could have voted, as directors, to withdraw their initial recommendation that the public shareholders approve the merger. The merger agreement also permitted General Cigar's board to entertain unsolicited acquisition proposals from potential acquirers if the board, upon recommendation by the special committee, believed that such a proposal would be more favourable to the public shareholders than the proposed merger with Swedish Match.

controlling shareholder was bound only in its capacity as a shareholder and nothing in the voting agreement limited its action as a director of the target company. In addition, the target board retained a "fiduciary out", allowing it to consider superior proposals and recommend against the current transaction. The transaction was also structured in a manner such that a majority of the non-affiliated public shareholders were free to reject the proposed deal on its merits, and no termination fee would be paid if such public shareholders rejected the proposed transaction. The decision reinforces the fact that the legality of deal protection measures must be considered in the context of the situation as a whole.

Another notable feature of the lock-up agreement related to voting requirements. Although the public shareholders were a "minority" in terms of voting power, the agreement required the Cullmans to vote their shares *pro rata* in accordance with the public shareholders which effectively gave the public shareholders a "veto" power over the proposed transaction. In the words of the Chancellor, "the merger could not proceed without approval by a majority of the minority".

The Delaware Court found that this situation was very different to the merger in *Omnicare*. There, the Supreme Court, applying the two-fold analysis of *Unocal*, found that the deal protection measures were "coercive and preclusive because they [presented] a *fait accompli*, i.e. they made it mathematically impossible and realistically unattainable for … any other proposal to succeed, no matter how superior the proposal". In applying the *Unocal* analysis in *Orman*, Chancellor Chandler noted that the first stage of the test requires the board to show that "they have reasonable grounds for believing that a danger to corporate policies and effectiveness" exists without the deal protection mechanism. This was satisfied in the instant case because Swedish Match "required" some form of deal protection during the negotiations that led to the merger and had the special committee and board not approved the deal protection devices, there was a risk of General Cigar losing the transaction and being left with no comparable alternative transaction.

Chancellor Chandler then noted that the second stage of *Unocal* requires the board to establish that the deal protection devices are: (i) not coercive or preclusive and (ii) within a reasonable range of responses to the danger to corporate policy and effectiveness. With respect to the first prong of this test, the Vice Chancellor concluded that "nothing in this record suggests that the lock-up had the effect of causing General Cigar's stockholders to vote in favour of the proposed transaction for some reason other than the merits of that transaction", and thereby adopted the standard for determining if deal protection measures are coercive from *Williams v. Geier*.

With respect to the second prong of this test, the Court firstly highlighted the risk to General Cigar shareholders of losing the Swedish Match transaction (and the significant premium it carried) and being left with no comparable alternative transaction and concluded that the General Cigar board should be afforded the maximum latitude regarding its decision to recommend the Swedish Match

merger. The Court then went on to review the fact that the General Cigar board retained a "fiduciary out", allowing it to consider superior proposals and recommend against the Swedish Match deal, the fact that a majority of the non-affiliated public shareholders were free to reject the proposed deal on its merits, and the fact that no termination fee would be paid if such public shareholders rejected the proposed transaction, and ultimately concluded that the Cullman lock-up "hardly [seemed] unreasonable, given the absence of other deal protection devices in this particular transaction and given the buyer's understandable concern about transaction costs and market uncertainties".

As a result, the Court disposed of the plaintiff's breach of fiduciary duty claim.

Emerging Communications, Inc. Shareholders Litigation
(2004), Del. Ch. Lexis 70
Court of Chancery, State of Delaware
May 3, 2004

The *Emerging Communications* decision addresses the merits of consolidated statutory appraisal claims and class actions for breach of fiduciary duty. The litigation arose out of the two-step "going private" acquisition of the publicly owned shares of Emerging Communications, Inc. (ECM), by Innovative Communications Corporation, L.L.C. (Innovative), ECM's majority stockholder. The first step of the transaction consisted of a cash tender offer which was commenced on August 18, 1998 by Innovative for ECM's publicly traded shares at a price of $10.25 per share. This was followed by a second step squeeze-out merger of ECM into an Innovative subsidiary, at the same price, on October 19, 1998.

In the Emerging Communications, Inc. Shareholders Litigation, the Delaware Chancery Court employed the "entire fairness" standard of review to determine whether directors had breached their fiduciary duties in the context of a non-arm's length "going-private" transaction. The Court found that, despite the existence of an independent committee of directors who engaged their own legal and financial advisors, there was an absence of fair dealing on the part of the directors and a failure by the directors to negotiate a fair price. The decision contains some rather insightful dicta with respect to the composition and effective functioning of independent committees and interestingly suggests that directors with specialized expertise will be held to a higher fiduciary standard.

At the time of the transaction, 52% of the outstanding shares of ECM, and 100% of the outstanding shares of Innovative, were owned by Innovative Communication Company, LLC (ICC). ICC, in turn, was wholly owned by ECM's Chairman and Chief Executive Officer, Jeffrey J. Prosser (Prosser). Thus, Prosser had voting control of both of the parties to the transaction.

ECM's principal business was the Virgin Islands Telephone Co. (Vitelco), which was the exclusive provider of local wired telephone services in the U.S. Virgin Islands. Vitelco was an extremely valuable asset for several reasons. At the time of the privatization, it faced no competition in the foreseeable future and was

guaranteed an 11.5% rate of return on the rate base for local telephone service by the Virgin Islands Public Service Commission. Vitelco was also a member of the Rural Telephone Finance Cooperative (RTCF), a non-profit lending cooperative that provided Vitelco with capital at below market interest rates. Vitelco had also been granted a five-year tax abatement from 90% of income taxes and 100% of gross receipts, property and excise taxes by the U.S. Virgin Islands Industrial Development Commission running from October 1998 to October 2003.

In June 1998, shortly after the privatization proposal was announced, a class action lawsuit for breach of fiduciary duty was brought on behalf of the former public shareholders of ECM by Brickell Partners, a former ECM shareholder. On February 10, 1999, four months after the privatization was consummated, an appraisal action was filed by Greenlight Capital, L.P. and certain of its affiliates (collectively, Greenlight). Greenlight also filed a separate fiduciary duty action on behalf of both its 750,300 "appraisal shares" and 2,026,685 ECM minority shares to which Greenlight had been assigned the litigation rights. Thereafter, the Brickell fiduciary duty action and the Greenlight appraisal and fiduciary duty actions were consolidated.

Entire Fairness Analysis

At the outset of the decision, the Court noted that in a class action seeking to invalidate a going-private acquisition of a corporation's minority stock by its majority stockholder, the standard under which the Court will review the validity of the transaction and the liability of the fiduciaries charged with a breach of their duty is the "entire fairness" standard, which has two aspects: fair dealing and fair price. In other words, the issue was whether the defendants dealt fairly with the ECM minority and whether the $10.25 per share transaction price was fair.

A. Fair Dealing Analysis

With respect to fair dealing, the Court noted that the threshold procedural issue was which side had the burden of proof. The Court went on to say that since the defendants stood on both sides of the transaction, the burden of proof would fall upon them, unless they could satisfy the Court that the transaction was approved by a fully functioning special committee of independent directors or by an informed majority of minority stockholders, in which event the burden would shift to the plaintiff to prove that the transaction was unfair.

The defendants argued that the burden of proof had shifted to the plaintiffs since the merger was approved by an informed independent committee of disinterested directors and an informed majority of minority stockholders. However, the Court disagreed and held that the committee of directors struck to consider the merger was not properly informed nor independent of Prosser, and that the transaction was not approved by an informed vote of a majority of ECM's minority stockholders. Interestingly, the defendants then argued that the burden of proof must nevertheless shift to the plaintiffs because the minimum tender condition (i.e., the condition that a majority of the minority shareholders tender into the offer) was the functional equivalent of a shareholder ratification of the transaction. However, the Court held that case law did not support the proposition that burden-shifting could be accomplished by a tender of shares as opposed to be an actual vote. Furthermore, it held that a tender should not be treated as the equivalent of an informed vote as stockholders have materially different interests at stake when tendering as opposed to voting their shares.

The Court then turned to the substantive fair dealing question, indicating that the analysis required the Court to consider issues such as how the transaction was timed, initiated, structured, negotiated, and disclosed to the board, and how director and shareholder approval was obtained.

Timing, Initiation and Structure

With respect to the structure of the transaction, the Court held that a "freeze-out" merger of the minority proposed by a majority stockholder is inherently coercive and is prima facie evidence of unfair dealing. The Court further held that another matter that evidenced the absence of fair dealing was the fact that the transaction had been timed in a manner that was financially disadvantageous to the stockholders and enabled the majority stockholder to gain correspondingly, noting in this regard that Prosser had timed the transaction to take advantage of ECM's temporarily and artificially depressed stock price. In addition, the Court noted that the transaction was also unfairly structured in that the legal and financial advisors to Prosser in the transaction had previously acted for ECM and were in the best position to represent the interests of the ECM minority. In this regard, the Court criticized the ECM board for not insisting that such legal and financial advisors remain as advisors to ECM and that Prosser retain other financial and legal advisors.

The Adequacy of the Minority Shareholders' Representation

In considering the adequacy of the representation of the interests of ECM's minority stockholders, the Court was critical of the fact that the majority of the Special Committee lacked independence and the one committee member who was arguably independent did not function effectively as a "champion" of the minority's interests. In this regard, the Court noted that directors who, through personal or other relationships, are beholden to the controlling stockholder in a going-private transaction lack independence from that person. In the case at bar, the Court pointed to consulting arrangements, legal fees generated that were attributable to work performed for Prosser and Prosser-owned entities and excessive directors' fees which were expected to continue (since all of ECM's directors, save for one, were appointed to the Innovative board after the privatization) as evidence of economic beholdance.

The Court further noted that the Special Committee was ineffective as the minority's representative because, as discussed further below, Prosser withheld relevant financial projections and therefore the Special Committee was deprived of information that was essential to an informed assessment of the fair value of ECM and of the gross inadequacy of the merger price Prosser was offering. This, the Court felt, disabled the Special Committee from negotiating vigorously or from shutting down the negotiations thereby preventing the privatization from going forward at all. The Court also noted that Prosser had misled the Special Committee by falsely representing that $10.25 per share was already straining the limits of the financing available to him. Interestingly, the Court was also critical of the fact that the Special Committee members were located on different continents, separated by a time difference of 14 hours and unable to meet in person. In addition, the Court noted that the Chairman of the Special Committee was careless, if not reckless, by routing all of his communications with the other Special Committee members through Prosser's secretary, providing Prosser with access to the Special Committee's confidential deliberations and strategy.

The Adequacy of the Board and Shareholder Approvals

With respect to the adequacy of the board and shareholder approvals of the transaction, the Court similarly held that the approvals were uninformed and, accordingly, of no legal consequence.

For all of these reasons, the Court concluded that the privatization transaction was the product of unfair dealing.

B. Fair Price Analysis

The fair price analysis undertaken by the Court involved an assessment of what ECM was intrinsically worth on the merger date. This required the Court to resolve a multitude of "discounted cash flow" (DCF) related valuation questions and prompted it to conclude that the $10.25 merger price was inadequate and that ECM's fair value (and the fair price for its shares) on the date of the merger was $38.05 per share.

Interestingly, the Special Committee's financial advisor had furnished a fairness opinion in connection with the transaction on the basis that the $10.25 transaction price was within the valuation ranges resulting from its market multiple analysis and DCF analysis prepared using the March projections. The Special Committee thereafter recommended that the ECM board approve the transaction and the ECM board approved the privatization.

The Appropriate Projections

The first issue addressed by the Court involved which set of management projections it was appropriate to use in the DCF valuation of ECM. Two sets of projections had been furnished to the Court: the first, delivered in March, were given to the Special Committee and its financial advisor; the second, prepared in June, were created closer to the merger date but were furnished only to Prosser, his advisors, and the RTFC in connection with the financing of the acquisition of ECM's minority shares, and not the Special Committee or its financial advisor. Not surprisingly, the June projections forecasted significantly higher growth.

In addressing the issue of what projections it was appropriate to use, the Court noted that as a general proposition, an appraiser should rely on a company's most recent contemporaneous management forecast unless there are compelling reasons to do otherwise. In the case at bar, the Court felt the facts compellingly pointed to reliance upon the June projections, which, unlike the March projections, incorporated ECM's first quarter of actual results as a stand-alone company. The June projections also incorporated significant post-March events that were not included in the March projections and would have to be considered in any valuation of ECM on the merger date. If only the March projections were used, those facts could not be considered. Also telling was that the June projections had been provided to Prosser's legal and financial advisors and to the RTFC, which used them to value ECM as collateral for the transaction financing. If contemporaneous reliance upon the June projections by Prosser, his

lender and his financial and legal advisors was appropriate, then the Court felt that logic and common sense dictated that reliance on those same projections by the Court was appropriate.

The Court rejected the defendant's argument that the merger-related synergies reflected in the June projections made the March projections more reliable. It asserted that if there had been true savings in relation to the consolidation of ECM and ICC's operations and the elimination of certain public company-related costs, the proper treatment would be to adjust the June projections for those merger-related cost savings, rather than discard those projections altogether. But more fundamentally, the Court held that the record showed that the alleged cost savings were not merger-dependent and were not supported by any credible evidence of record. In this regard, the Court noted that in an appraisal proceeding, each party must bear the burden of establishing its own position.

The Court further felt the March projections were inappropriate since even the defendants' expert who relied upon them conceded that they would have to be modified by making large adjustments to critical inputs. The effect of those inputs was to depress the cash flows that management had contemporaneously projected. The Court noted that the case law clearly and consistently indicated a preference for the most recently prepared management projections available as of the merger date and scepticism of *ex post* adjustments to such projections. The key question was whether the defendants had offered legitimate reasons for its expert's modifications to the March projections. The Court concluded that it had not, stating that the adjustments made merely represented a substitution of the expert's personal judgment of what projected capital expenditures should be for the non-litigation business judgment of ECM's management, without demonstrating that his view was generally accepted or that management habitually underestimated ECM's Capex.

The Appropriate Discount Rate

The next issue considered by the Court concerned the appropriate discount rate to utilize for purposes of discounting the projected free cash flows.

Both of the competing experts determined their discount rate(s) using the weighted average cost of capital (WACC) and capital asset pricing model (CAPM) formulas. The plaintiffs used the WACC formula, without adjustment, to calculate a discount rate of 8.8% during the 1998-2002 period when ECM's tax

abatement would be in effect and 8.5% thereafter, assuming that ECM's tax abatement would not be renewed. The defendants also used the WACC model, but modified the formula and its inputs by adding various premiums, substituting new debt costs, and using a different debt-to-equity weighting, to arrive at a discount rate of 11.5%. The approximately 3% discrepancy between the two experts' discount was attributable primarily to their different determinations of the cost of debt, capital structure and cost of equity.

The plaintiffs based their cost of debt calculation on ECM's historical ability to borrow from the RTFC at below market rates. The defendants, on the other hand, assigned ECM a higher cost of debt based on their assumption that ECM would not be able to borrow indefinitely at the discounted rate. The Court disagreed with the defendants' position, highlighting that there was nothing on the record to indicate that on the merger date, ECM would not have been able to borrow at the weighted average cost of its existing debt.

In assessing the percentage of the capital structure represented by equity and by long-term debt to be considered in the WACC formula, the Court relied on Bradford Cornell's treatise *Corporate Valuation, Tools for Effective Appraisal and Decision Making* (McGraw-Hill 1993) to reject, in part, the approach taken by both sides. The Court noted that a simple and popular procedure for estimating target weights is to assume they equal the company's current market value weights. However, the Court adopted Cornell's caution against the intrinsic circularity in the WACC formula: in most cases, a company is being appraised because the market value of its securities is unknown, and, therefore, this value cannot be used to calculate the weights. To overcome this difficulty, the Court held that one must employ an iterative procedure which is commenced by selecting an initial estimate for the market value of the equity, which may reasonably be the book value of the equity.

Ultimately, the Court held that it was unable to accept the enterprise value calculated by either side because in each case it was identical to their respective "fair value" calculations, highlighting exactly the circularity in WACC. The Court therefore made its own enterprise valuation of ECM that was not litigation-driven. Based on the record, the only such valuation was the $27.84 per share value, based on a 12% discount rate, that the RTFC had determined and actually used for purposes of financing the privatization.

As for the percentage represented by long-term debt, the only data credibly anchored to the record was the RTFC's determination of ECM's net-debt-to-value ratio at 38.8%. Because that ratio was conservatively determined and was calculated as of July 29, 1998, three months before the merger, the actual debt-to-value percentage as of the merger date was unknown. The Court concluded that a debt-to-value ratio of 38% would have been a reasonable estimate and input for purposes of determining a discount rate as of the merger date. Accordingly, the Court concluded that the percentage of ECM's capital structure represented by equity would have been 62% (i.e., 100%-38%).

Both sides used the CAPM formula to calculate ECM's cost of equity, however, the defendants added a "small stock premium" of 1.7% and a "company-specific premium" of 2.4%, the latter consisting of a 1 to 1.5% "super-small stock premium" and a .9 to 1.4% "hurricane-risk premium". The Court noted that the defendants carried the burden of showing that such additions were appropriate.

The Court then held that there was support both in the finance literature and the case law for the propriety of a small firm/small stock premium in appropriate circumstances. It concluded that despite the fact that ECM did not fit the profile of a "small company" in relation to factors other than its size, those favourable characteristics did not justify ignoring the incremental risk, not fully captured by beta, that typically accompany a small sized firm.

However, the defendants failed to satisfy their burden in relation to the "super-small stock premium" and the "hurricane-risk premium". The Court found that the defendants offered nothing to persuade it that ECM's risk profile fit that of a micro-cap company. ECM was small, but it was also a utility that was unusually protected from the hazards of the marketplace in terms of its lack of competition and preferred borrowing rates. Additionally, the defendants provided no theoretical or evidentiary support for the position that the risk of unrecoverable hurricane damage loss is so embedded in ECM's business as to require a structural increase in ECM's cost of equity.

ECM's Market Price As Evidence Of Fair Value

The final issue considered by the Court centered on the questions of what weight should be accorded to ECM's stock market price in determining its fair value; and whether the appraisal (or damages) award should include the value.

In this regard, the Court noted that Delaware law recognizes that, although market price should be considered in an appraisal, the market price of shares is not always indicative of fair value for purposes of the entire fairness test. To support their claim that the fair value of ECM was not more than $10.38, the defendants argued that the market for ECM's shares was active and efficient. However, the Court held that the record undermined any assertion that ECM's common stock was traded in an efficient market. Indeed, it was precisely because ECM's stock market price did not reflect ECM's underlying values that Prosser decided to acquire the ECM minority interest in the privatization, and Prosser himself told his fellow ECM directors that the ECM stock price had failed to reach the desired appreciation as a result of the small public float and the fact that the stock was not being followed by Wall Street analysts. Moreover, because Prosser always owned the majority interest, the market price of ECM stock always reflected a minority discount. Therefore, the Court felt that ECM's unaffected stock market price merited little or no weight in an assessment of fair value.

The Fair Value Of ECM And The Unfairness Of The Merger Price

Based on its above-noted determinations, the Court concluded that the fair value of ECM on the merger date was $38.05 per share. From that fair value finding, the Court felt that it followed that the $10.25 per share merger price was not a "fair price" within the meaning of the Delaware fiduciary duty case law.

C. Conclusion and Disposition

As a result of the Court's unfair price determination and its conclusion that the transaction was also the product of unfair dealing, the Court accordingly concluded that the transaction was not "entirely fair" to the minority stockholders of ECM. Accordingly, the Court ruled in favour of the plaintiffs and held two directors jointly and severally liable.

Interestingly, one of the two directors found liable was a securities analyst who the Court held possessed "significant experience in finance and the telecommunications sector" and felt ought to have known the offer price wasn't fair. This dicta appears to stand for the proposition that directors with specialized expertise and knowledge can be held to a higher standard.

III. REGULATORY DEVELOPMENTS

A. Canadian Regulatory Developments

LEGISLATIVE INITIATIVES IN ONTARIO AND BRITISH COLUMBIA CREATING STATUTORY SECONDARY MARKET LIABILITY REGIMES

After years of discussion, new legislative initiatives in Ontario and British Columbia will give investors who acquire securities in the secondary market rights of action against issuers, directors, officers experts and major securityholders for misrepresentations and failures to make timely disclosure of material changes

The governments of Ontario and British Columbia have indicated their intention to implement new statutory regimes for civil liability for secondary market disclosure (set out in Ontario Bill 149 and British Columbia Bill 74) that are expected to come into force in 2005. The introduction of statutory secondary market liability into the securities legislation of Ontario and British Columbia will give secondary market investors potential causes of action against corporations, directors, officers, major securityholders and experts (among others) with respect to misleading statements and failures to make timely disclosure of material changes.

While the ability to bring an action will presumably be limited to securityholders with a connection to Ontario or British Columbia, there is no jurisdictional limitation with respect to the corporations that such securityholders can sue. The most public companies with Canadian securityholders will wish to adopt corporate governance practices that comply with both the Ontario and B.C. regimes.

The new legislation will create partial liability schemes, rather than fully compensatory ones, inasmuch as potential damages will sometimes be capped. The damages cap for the corporation itself will be the greater of 5% of market capitalization and $1 million. For other defendants, caps will apply only where the plaintiff fails to prove that the defendant knew of the misconduct (or, under B.C.'s legislation only, that it *should* have known). Where caps do apply, the limit on damages against an expert will generally be equal to its previous 12 months' compensation (though Ontario's legislation mandates a minimum cap for experts of $1 million), while the cap on damages against individual defendants other than experts (including directors and officers) will generally be the greater of $25,000 or 50% of their previous 12 months' compensation. The calculation of damages, prior to applying any relevant caps, will be left to the court's discretion in British Columbia, while courts in Ontario will usually employ a set of statutory formulas generally intended to track the actual loss suffered by the investor as a consequence of trades made during the period that the misrepresentation or failure to disclose remained uncorrected.

A Powerful Tool for Investors

As the scope of the potential damages suggests, the new legislation has the potential to become a powerful tool for investors. Several other facts about the legislation support this contention. Neither statute requires plaintiffs to prove reliance. In fact, the Ontario legislation expressly excludes reliance from the court's consideration, except insofar as the defendant can prove that the plaintiff knew of the misconduct when it made its investment decision. Nor is it necessary, under either regime, to prove that the misconduct actually caused the relevant price change, though the defendant is free to try to prove otherwise. There is some protection against nuisance or "strike" suits, however, inasmuch as actions cannot proceed without the leave of a court.

Actionable misrepresentations under the statutes include those in documents filed under securities or corporations law or in any other document if they might reasonably have been expected to appear important to an investor (B.C.) or likely to influence the security's market price (Ontario). Misrepresentations in public oral statements are also actionable, provided that it was reasonably foreseeable that they would be generally disclosed. The precise descriptions of the types of statement that can form the subject of a lawsuit differ between the Ontario and B.C. legislation.

Who Can Be Liable

Who can be liable depends on the circumstances of the misconduct. Where a misrepresentation is made by an issuer, for example, both regimes allow for a finding of liability against the issuer itself, its directors and officers, and experts who were involved in the misrepresentation. The statutes also create potential liabilities for other parties, including major securityholders (over 20% in Ontario; over 10% of any class in B.C.), as well as those variously described as "insiders" (Ontario), "promoters" (Ontario) and securityholders who are able to "affect materially the control of the [issuer]" (both).

Directors' Liability

Under Ontario's legislation, directors will generally not be liable for a misrepresentation or failure to disclose for which they did not give their authorization, permission or acquiescence (misrepresentations in documents issued by the corporation are an important exception to this rule). In all cases except those of certain "core" documents, a plaintiff must prove that a director knew or avoided learning of the misrepresentation (or failure to disclose) or was

otherwise guilty of gross misconduct. The British Columbia regime generally holds directors of the corporation to what appears to be a higher standard. It does not immediately require the plaintiff to prove knowledge, nor does it permit directors to raise non-authorization (etc.) as a defence. Instead, the B.C. legislation takes a "carrot and stick" approach. *If* the corporation implements and monitors a "reasonable system" designed to ensure compliance with the *Securities Act*, its directors (and the corporation itself) will have a strong defence against liability. Where such a system has been implemented, the plaintiff will *then* generally have to prove that the director knew or should have known of the misconduct *and* that it constituted a contravention of the B.C. *Securities Act*.

Experts' Liability

Where an issuer releases a document or makes a public oral statement that relates to the business or affairs of the issuer and such document or public oral statement contains a misrepresentation, an expert will generally be liable for a misrepresentation contained in such document or public oral statement where: (i) the misrepresentation is also contained in a report, statement or opinion made by the expert, (ii) the document or public oral statement includes, summarizes or quotes from the report, statement or opinion of the expert, and (iii) if the document or public oral statement was released or made by a person or company other than the expert, the expert consented in writing to the use of the report, statement or opinion in the document or public oral statement.

Defences

The Ontario legislation also refers to the existence of a system designed to ensure compliance, but only as one factor that courts may take into account in considering the defendant's assertion of a "due diligence" defence. If a defendant, including an expert, can show that it conducted a "reasonable investigation" prior to the misconduct, and that, having done so, it did not know and could not reasonably have known that the action in question constituted misconduct, it will not generally be liable.

Other available defences include: (i) a safe harbour for forward-looking information (provided that it has a "reasonable basis", is identified as forward-looking, and is accompanied by a statement of the material factors or assumptions on which it is grounded); (ii) reliance on an expert (provided that written authorization has been received and that the statement fairly represents the expert's opinion); and (iii) reliance on documents filed by other public

companies. Generally, these defences require that the defendant reasonably or honestly believed that the statements in question were true.

Responding to the New Regimes

The new regimes will affect the corporate disclosure policies of many public companies doing business in Canada. We are already seeing the creation, enforcement and monitoring of compliant disclosure policies, as well as greater board oversight of these policies than in the past. Because the liability of individual parties will often hinge on their knowledge of a given misrepresentation or failure to disclose, it will also be increasingly important for directors, officers, experts, significant shareholders and others to maintain accurate records of their corporate involvements. Finally, all potential defendants need to become informed of their responsibilities under the new system and should review their liability insurance options.

RECENT CANADIAN CORPORATE GOVERNANCE INITIATIVES

Disclosure Matters

On October 29, 2004, proposed National Instrument 58-101 *Disclosure of Corporate Governance Practices* (the Disclosure Instrument) and proposed National Policy 58-201 *Corporate Governance Guidelines* (the Best Practices Policy) were published for comment. The proposals, which represent initiatives undertaken by every securities regulatory authority in Canada, are similar in substance to the NYSE's corporate governance listing standards and reflect Canadian and U.S. best practices. The Disclosure Instrument and the Best Practices Policy are collectively referred to below as the "New Proposals".

The comment period on the New Proposals expired in December 2004. Pursuant to CSA Staff Notice 58-302 *Implementation of Corporate Governance Policy and Related Disclosure Instrument* (dated January 21, 2005), CSA Staff are currently considering the comments received and incorporating changes as appropriate. Subject to receiving all necessary approvals, CSA Staff anticipate that the New Proposals will apply to information circulars which are filed following financial years ending on or after June 30, 2005.

The New Proposals apply to reporting issuers. In addition to corporations, they also apply to limited partnerships and various other non-corporate issuer entities, including income trusts. The application to income trusts recognizes that certain

Responsibility for overseeing corporate governance disclosure is set to shift from the Toronto Stock Exchange to the Canadian securities regulatory authorities. In keeping with the current TSX requirements, as opposed to a system based upon mandatory compliance, the securities' regulators have proposed a system that requires issuers to make certain governance-related disclosures that provide the marketplace with enhanced transparency. However, the focus has shifted such that rather than being required to explain why a particular recommended best practice is not complied with, an issuer will be required to describe its adopted corporate governance practice and, where it differs from a recommended best practice, what is being done to satisfy the

objectives of such best practice. Upon the implementation of the corporate governance initiatives, a failure to disclose corporate governance practices will be treated as a securities law violation and issuers will be subject to the enforcement powers of the securities' regulators.

In another regulatory development, although CEOs and CFOs are now required to certify the accuracy of annual and interim financial statements, securities' regulators have responded to pressure to allow issuers additional time to certify the adequacy of internal controls over financial reporting.

functions of a corporate issuer, its board and its management may be performed by any or all of the trustees, the board or management of a subsidiary of the trust, or the board, management or employees of a management company. The New Proposals do not, however, apply to investment funds, issuers of asset-backed securities, designated foreign issuers and SEC foreign issuers (each as defined), certain exchangeable security issuers, certain credit support issuers and certain wholly-owned subsidiary issuers.

In comparison to the current situation, where corporate governance disclosure obligations are solely a TSX requirement, under the New Proposals the Canadian securities regulators are expected to be able to more effectively enforce violations of corporate governance requirements. In particular, the failure by an issuer to provide adequate disclosure will constitute a breach of securities laws and expose the issuer and others to enforcement proceedings and sanctions.

Disclosure Instrument

The Disclosure Instrument requires issuers to make certain governance-related disclosures. The stated purpose of the Disclosure Instrument is to provide greater transparency for the marketplace of an issuer's corporate governance practices. It includes both mandatory disclosure requirements (principally in an issuer's management proxy circular) and the requirement to file on SEDAR any written code of business conduct and ethics (and amendments thereto) that an issuer has adopted.

The disclosure items required under the Disclosure Instrument generally correspond to the guidelines in the Best Practices Policy. However, a key difference between the Disclosure Instrument and previous initiatives is that the focus has shifted from explaining differences to describing practices. In other words, under the Disclosure Instrument, an issuer will be required to describe its adopted corporate governance practices, as opposed to being required to explain why a particular recommended best practice is not complied with. This means that where there is divergence, an issuer will have to describe what is being done to satisfy the objectives of a recommended best practice.

Recognizing that many smaller issuers will have fewer formal procedures in place, the Disclosure Instrument imposes fewer disclosure obligations on issuers that do not have any securities listed or quoted on the TSX, a U.S. marketplace or a marketplace outside of Canada and the U.S. (i.e., venture issuers).

Best Practices Policy

The stated purpose of the Best Practices Policy is to provide guidance on corporate governance practices, which are not intended to be prescriptive. Issuers are encouraged to consider the guidelines in developing their own corporate governance practices but will not be required to disclose their practices in comparison to the guidelines contained in the Best Practices Policy.

To a significant extent, the Best Practices Policy reflects existing TSX corporate governance guidelines. However, the Best Practices Policy also reflects U.S. initiatives under the Sarbanes-Oxley Act of 2002 and newly adopted corporate governance rules of the NYSE and NASDAQ.

The following is a short summary of some key elements of the Best Practices Policy:

- *Independence:* The board should have a majority of independent directors. (A director is independent if he or she has no direct or indirect material relationship with the issuer.)

- *Chair:* The board chair should be independent or an independent lead director should be appointed.

- *Meetings of Independent Directors:* The independent directors (not just non-management directors) should hold regularly scheduled meetings at which members of management are not in attendance.

- *Board Mandate:* The board should adopt a written mandate in which it explicitly acknowledges responsibility for the stewardship of the issuer (including responsibility for certain prescribed matters, many of which overlap with existing TSX Corporate Governance Guidelines). The board's written mandate should also include expectations and responsibilities of directors, including basic duties and responsibilities with respect to attendance at board meetings and advance review of meeting materials.

- *Position Descriptions*: The board should develop clear position descriptions for the board chair and the chair of each board committee and, together with the CEO, the board should develop a clear position description for the CEO that delineates management's responsibilities. The board should also develop or approve the CEO's corporate goals and objectives.

- *Director Education*: The board should ensure that all new directors receive comprehensive orientation regarding both the business of the issuer and director duties. Continuing education should also be provided to all directors.

- *Code of Business Conduct and Ethics*: The board should adopt a written code of business conduct and ethics applicable to directors, officers and employees. This code should contain written standards that are reasonably designed to promote integrity and to deter wrongdoing, and should address certain prescribed matters. In addition, the board should be responsible for monitoring compliance with the code, and any waivers from the code that are granted for the benefit of directors or executive officers should be granted by the board or a board committee only. In contrast to earlier proposals, issuers are not required to file a press release in respect of such waivers from the code. However, consideration must be given to whether conduct by directors or executive officers constitutes a material departure from the code. If so, the regulators indicate that they would likely take the view that a "material change" has occurred, thereby requiring the issuer to file a press release and material change report. The Disclosure Instrument also provides that the code (and any amendments thereof) must be filed on SEDAR, and the issuer's management proxy circular must disclose how interested parties can obtain a copy.

- *Nomination of Directors*: The board should appoint a nominating committee composed entirely of independent directors and such committee should adopt a written charter. If such a committee exists, its responsibilities, powers and operation must be described in the issuer's management proxy circular.

- *Recruitment of Directors*: The nominating committee of the board should, among other things, adopt a process for determining the competencies and skills that the board should have as a whole and should apply this to the recruitment process for new directors.

- *Compensation*: The board should appoint a compensation committee responsible for certain prescribed matters and composed entirely of independent directors and this committee should adopt a written charter. If such a committee exists, its responsibilities, powers and operation must be described in the issuer's management proxy circular.

- *Board Assessments*: Regular assessments of board effectiveness and the effectiveness and contribution of each board committee and each individual director should be conducted.

Audit Committee Instrument: Meaning of Independence and Material Relationship

Amendments are also being proposed to Multilateral Instrument 52-110 *Audit Committees* (the Audit Committee Instrument) and its companion policy by the Canadian securities regulators (other than British Columbia, which on February 4, 2005 proposed its own rule on audit committees, which exempts issuers that comply with the Audit Committee Instrument) to clarify the definition of "independence" and to ensure the consistency of this definition with the New Proposals and recent amendments to the NYSE's corporate governance listing standards.

The amendments propose to separate certain deeming provisions that would disqualify a director from being considered independent. By clearly identifying which deeming provisions apply solely for the purposes of Audit Committees (whose members must satisfy additional more rigorous criteria, e.g., financial literacy), the changes help to ensure the consistency of the definition with the New Proposals.

A director is independent if he or she has no direct or indirect material relationship with the issuer. A material relationship is defined as a relationship that could, in the view of the issuer's board, be reasonably expected to interfere with the exercise of a board member's independent judgment. A board should

assess all relationships between the issuer and an individual in order to determine whether any material relationship exists, although share holdings alone will not lead to a conclusion that there is a lack of independence.

Various provisions included in the Audit Committee Instrument specifically deem certain individuals to have a material relationship with an issuer. For example, if an individual is, or was within a three-year period (subject to a phase-in requirement) one of the following, then that individual would automatically not be considered independent. Immediate family members having relationships similar to those described below may also taint an individual's independence.

- An employee or executive officer of the issuer;
- A partner or employee of the internal or external auditor of the issuer or a former partner or employee of the auditor if he or she personally worked on the issuer's audit;
- An executive officer of another entity if a current executive officer of the issuer serves or served at the same time on the compensation committee of the other entity; or
- A person who is in receipt of more than $75,000 in direct compensation from the issuer during any twelve-month period (except compensation for acting as a director or committee member), other than fixed amounts of compensation under a retirement or deferred compensation plan for prior service with the issuer, provided such compensation is not in any way contingent on continued service.

Since the three-year period indicated above is being phased in over time, it will not apply to any relationships that ended prior to March 30, 2004. In other words, relationships ending before that date will not taint an individual's independence.

OSC staff has confirmed that the heightened standards of director independence applicable to Audit Committee members will not apply to directors for general director independence purposes. This approach is consistent with the U.S. requirements.

B. CEO/CFO Certification

Pursuant to Multilateral Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings* (the Certification Instrument), the securities regulatory authorities (the Securities Regulators) in every province and territory in Canada excluding British Columbia (where the current rule is not in force), require that CEOs and CFOs of all Canadian public companies personally certify that:

- To their knowledge, the issuer's annual or interim filings, as the case may be, do not contain any misrepresentations or omissions and that they fairly present in all material respects the issuer's financial condition, results of operations and cash flows. Annual and interim filings include an issuer's annual information form, annual and interim financial statements and annual and interim MD&A. "Fair presentation" is indicated in a companion policy to refer to, without limitation, (i) the selection and proper application of appropriate accounting policies, (ii) the disclosure of financial information that is informative and reasonably reflects the underlying transactions, and (iii) the inclusion of additional disclosure necessary to provide investors with a materially accurate and complete picture of the issuer's financial condition, results of operations and cash flows; and

- They have designed (or caused to be designed under their supervision) and implemented disclosure controls and procedures and internal controls (but see below) to provide reasonable assurances that (i) material information relating to the issuer is made known to them, particularly during the applicable time, and that such information is disclosed within the time periods specified under applicable securities legislation, and (ii) the issuer's financial statements are fairly presented in accordance with generally accepted accounting principles.

The wording of the certification must be exactly as set out in the Certification Instrument. An officer providing a false certification could potentially be subject to quasi-criminal, administrative or civil proceedings under securities laws.

In addition, it should be noted that on November 26, 2004, the Securities Regulators released for comment proposed amendments to the Certification Instrument to postpone a requirement that CEOs and CFOs of public companies provide certain certifications with respect to their company's internal controls over financial reporting.

If adopted, the proposals would allow CEOs and CFOs more time to satisfy themselves that they have an appropriate basis for providing their required certifications with respect to such internal controls.

Specifically, CEOs and CFOs would have until their first financial year ending on or after June 30, 2006 (i.e., by mid-May 2007 for most companies with calendar year-ends) to:

- Acknowledge their responsibility for establishing and maintaining internal controls over financial reporting;

- Certify that such internal controls have been designed (or caused to be designed under their supervision) to provide reasonable assurance regarding the reliability of financial reporting and the preparation of external financial statements in accordance with GAAP; and

- regarding internal controls over financial reporting that materially affect, or are reasonably likely to materially affect, such internal controls.

The proposals do not impose any additional requirements on public companies and have not changed the implementation date under the Certification Instrument regarding certification of disclosure controls and procedures by CEOs and CFOs, which are still expected to be required for financial years ending on or after March 31, 2005 (i.e., by mid-May 2006 for most companies with calendar year-ends). Public comments on the proposals are being sought by the Securities Regulators and submissions must be received no later than February 24, 2005.

In addition, internal control effectiveness certification is the subject of a proposed new rule released by the Canadian securities regulators (excluding British Columbia) on February 4, 2005 that, as in the U.S., would require company management and its external auditor to assess the effectiveness of internal controls. The comment period on Proposed Multilateral Instrument 52-111 *Reporting on Internal Control Over Financial Reporting* (the "Internal Control Instrument") expires on June 6, 2005. As a result, certain changes to the Certification Instrument have also been proposed.

The provisions of the proposed Internal Control Instrument regarding internal control reports and internal control audit reports are currently expected to be implemented for financial years ending on or after June 30, 2006, subject to certain proposed transitional rules based on the market capitalization of a company. For example, in addition to satisfying any other applicable exemption conditions, companies with market capitalizations of (i) less than $75 million would be permitted a three year delay, (ii) more than $75 million but less than $250 million would be permitted a two year transition period, and (iii) more than $250 million but less than $500 million would be permitted a one year extension.

Alternative approaches to regulating internal control are also being considered by the Canadian securities regulators and various examples have been described in their request for public comments on the Internal Control Instrument. The British Columbia Securities Commission is also accepting public comments until June 4, 2005 on their reasons for not adopting the Internal Control Instrument and their views on alternative approaches.

CSA PROVIDES GUIDANCE ON ENHANCED DISCLOSURE OF RETIREMENT BENEFITS

On January 14, 2005, *CSA Staff Notice 51-314 – Retirement Benefits Disclosure* (the Notice) (which staff of the British Columbia Securities Commission did not participate in) was issued to provide guidance to those issuers who choose to provide enhanced disclosure of retirement benefits payable to executives which goes beyond the strict securities law requirements specified in *Form 51-102F6 - Statement of Executive Compensation of National Instrument 51-102 Continuous Disclosure Obligations* (the Form). The release of the Notice follows increased recent public attention to the pension portion of corporate executives' remuneration packages.

The Canadian securities' regulators have provided guidance for issuers that choose to provide additional disclosure of retirement benefits for executives. The guidance provides insight into how the regulators will view the adequacy of voluntary disclosure on pension benefits.

Additional disclosure considered by some issuers might include information about the value of certain retirement benefit plans, for example, supplementary executive retirement plans (SERPs). According to the Form, an issuer is required to provide general information regarding estimated annual benefits payable under defined benefit plans. An issuer must also disclose certain other information, including the relationship between the amount of compensation covered under the plan and the compensation reported elsewhere in the proxy circular, as well as the estimated credited years of service for each named executive officer.

The Notice includes three different types of additional disclosure that issuers may consider. The examples are not designed to be exhaustive and the guidance contained in the Notice would also apply to any other type of additional disclosure regarding retirement benefits. The additional disclosure can be provided in either narrative or tabular form, and can be included with an issuer's executive compensation disclosure. Examples of additional disclosure could include, among other information:

- The total retirement benefit liability of the issuer associated with each executive;
- The total service costs in respect of the plan during the past year; and
- The estimated annual benefits payable on retirement to specific executives.

Although this additional disclosure is not mandatory, the Notice indicates that when issuers choose to provide such information, it is important that the disclosure includes specific information that will assist an investor in understanding it. For example, the disclosure should specify: (i) that the amounts are estimates based on assumptions that represent contractual entitlements which may change over time (and to disclose key contractual terms of benefit plans if they are unusual or their impact is significant); (ii) that the methods used to determine any estimated amounts will not be identical to the methods used by other issuers and that, as a result, the figures may not be directly comparable across companies; and (iii) the key assumptions made.

These key assumptions should be consistent with those used by the issuer for financial statement purposes, and any major differences in the assumptions used should be explained. The Notice indicates that, where appropriate, it may be helpful to investors if information is disclosed using different assumptions, such as different vesting dates or different retirement ages of executives. Examples of key assumptions in determining the value of benefit plans include:

- *Retirement*: Issuers will need to make assumptions about the length of time an officer will remain employed.
- *Vesting*: Some pension benefits will not vest until a future date and their current value will need to be estimated for disclosure purposes.

- *Increases in compensation*: Issuers must take into account future pay increases granted to executives when estimating a value for retirement benefits since benefits are typically based on the executive's income in the years immediately before retirement. Issuers must also consider how to reflect any changes to the disclosure when actual amounts differ from what was originally estimated and disclosed.

- *Interest rates*: Issuers must determine whether to use pre-tax or after-tax interest rates when determining the value of benefits granted to executives.

- *Employee contributions*: When the pension plan includes employee contributions, issuers may wish to disclose whether such contributions are included in estimated figures for benefits or liabilities and how they are taken into account.

The Notice is only a guideline for optional additional disclosure and does not purport to be exhaustive. It does, however, provide some insight into how the securities regulators (excluding in BC) may review the sufficiency of information disclosed by an issuer.

The National Association of Securities Dealers has solicited views on whether it should implement policies to regulate the practice among its members of providing fairness opinions. In particular, the NASD is considering whether it should implement disclosure requirements and procedural safeguards to ensure that investors are fully informed where the provider of a fairness opinion may have a conflict of interest.

B. U.S. Regulatory Developments

NASD ANNOUNCEMENT RE: FAIRNESS OPINIONS

In the fall of 2004, the National Association of Securities Dealers (NASD) made an announcement requesting comments on whether it should propose a new rule concerning fairness opinions in the context of certain corporate transactions. In the request for comments, the NASD noted that investment banks typically provide fairness opinions in transactions such as mergers and acquisitions, the divestiture of material assets, divisions or subsidiaries, and buybacks of outstanding securities. The NASD further noted that although fairness opinions are not required by statute or regulation, they have been a regular feature of corporate transactions for nearly 20 years, and that corporations routinely disclose fairness opinions in documentation and regulatory filings that are often referred to by investors.

The rationale for the proposed rule is the concern expressed by commentators with respect to conflicts of interest that might arise in the process of an investment bank rendering a fairness opinion. For example, investment banks may be influenced by whether the company's management supports the transaction, and the NASD notes that this conflict may be especially strong when a management-supported transaction is also one in which the investment bank acted as the financial advisor to the company in connection with the transaction and/or where the investment bank will receive financial advisory fees upon successful completion of the transaction.

The NASD is specifically considering whether to propose a new rule that would require members to:

1. Disclose in any fairness opinion appearing in any proxy circular any significant conflicts of interest, including, if applicable, that the member has served as an advisor on the transaction in question, and the nature of compensation that the member will receive upon the successful completion of the transaction (including any variance or contingency in the fee charged for the fairness opinion); and

2. Require specific procedures that members must follow to identify and disclose potential conflicts of interest in rendering fairness opinions. In this regard, the NASD notes that such procedures could address the substantive

> factors used by members in reaching a fairness opinion, including: (i) the process by which fairness opinions are approved by a firm, including whether the firm uses a fairness committee, and, if so, the selection of personnel for the fairness committee, the level of experience of such persons, procedures designed to provide balanced review, and whether steps have been taken to require review by persons whose compensation is not directly related to the underlying transaction; (ii) the process to determine whether the valuation analyses used are appropriate for the type of transaction and the type of companies that propose to participate in the transaction; and (iii) the process to evaluate the degree to which the amount and nature of the compensation from the transaction underlying the fairness opinion benefits any individual officers, directors or employees, or class of such persons, relative to the benefits to shareholders of the company, is a factor in reaching a fairness determination.

The NASD also notes that such a rule could require a member to disclose the extent to which the firm relied on key information supplied by a company or its management, or whether it independently verified certain information.

Interestingly, the disclosure aspect of the proposed rule would be similar to that set out in the relevant portion of the *Policy of the Director Concerning Arrangements Under Section 192 of the Canada Business Corporations Act* (the Act) published on March 30, 2004. In the Policy, it is stated that while fairness opinions are not required under the Act, the Director "strongly endorses the practice of obtaining fairness opinions as a means of providing objective evidence that a proposed arrangement is fair", and that a party who does not obtain a fairness opinion "should be prepared to justify its position to the Director". The Policy goes on to state that ideally, fairness opinions should be provided by financial advisors who are independent from all parties involved in the arrangement, and that disclosure is required of any relationship between the investment bank and any party involved in the transaction and whether their compensation is, in any way, contingent upon the consummation of the transaction.

The comment period on the NASD proposal expired on February 1, 2005 and the NASD has not yet announced how it intends to proceed.