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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The Canadian Institute of Chartered Business Valuators and Stikeman Elliott LLP

I. CANADIAN DECISIONS

page 4
Peoples Department Stores Inc. (Trustee of) v. Wise
[2003], 41 C.B.R. (4th) 225
Québec Court of Appeal
(February 5, 2003)
(Leave to appeal to the Supreme Court of Canada granted [2003] S.C.C.A. No. 133)
(Notice of appeal filed September 23, 2003)

The Quebec Court of Appeal overturned the trial judge's ruling that directors owe duties to creditors in near-insolvency situations. The court was reluctant to link the rights of creditors with those of shareholders, even when bankruptcy was imminent. The Quebec Court of Appeal stated that extension of director liability in this context would constitute an encroachment upon the legislated regime of director liability to third parties.

page 7
Saarnok-Vuus v. Teng
[2003], 31 B.L.R. (3d) 92
British Columbia Supreme Court
(February 14, 2003)

The British Columbia Supreme Court ruled that the actions of one of two shareholders of a closely-held company to prevent the other shareholder from having any say in the affairs of the company were oppressive, even though the conduct was in accordance with the company's Articles. The Court held that where the alleged conduct is authorized by law, an element of bad faith must be proven in order to establish the conduct as oppressive. Where bad faith is established, the Articles cannot be used to perpetuate a situation of conflict between the shareholders that is not in the best interests of the company.

page 9
Vlasblom v. NetPCS Networks Inc.
[2003], 31 B.L.R. (3d) 255
Ontario Superior Court of Justice
(February 20, 2003)

The plaintiff was an employee of the defendant company and alleged that the conversion of previously issued debentures to common shares by a venture capital firm, and the issuance of further shares to key executives for nominal consideration, was tantamount to oppression. The Court dismissed the action, finding that the issuance of the shares was necessary to facilitate a financing required to keep the company in business. The issuances and any consequent dilution of the shares held by the plaintiff were found to be in the best interests of the company.

page 12
Dylex Ltd. (Trustee of) v. Anderson
[2003], 63 O.R. (3d) 659
Ontario Superior Court of Justice
(March 11, 2003)

The former directors and senior officers of Dylex Ltd. brought motions to strike oppression and breach of fiduciary duty claims asserted by the trustee in bankruptcy of Dylex on behalf of creditors, arguing that the trustee did not have the legal capacity to bring such claims. Noting that the law on the subject remained unsettled, the Court rejected the directors' motions on the grounds that the trustee was akin to a representative of the creditors and their interests, and in this role, the trustee was the proper party to assert the oppression and breach of fiduciary duty claims.

Corporate / Securities Decisions and Regulatory Developments (cont'd.)

page 14

Pasnak v. Chura
[2003], B.C.J. No. 1591
British Columbia Supreme Court
(July 2, 2003)

The plaintiffs asked that the Court order a sale of the defendants' shares at a price less than their assessed value, claiming that negative adjustments should be made because of the actions of one of the shareholders. The B.C. Supreme Court declined to do so and reasserted the fundamental principle that a company and its shareholders are distinct entities, with independent rights and obligations.

page 16

Harding v. First Associates Investments Inc.
[2003], O.J. No. 3220
Ontario Superior Court of Justice
(August 14, 2003)

The Ontario Superior Court of Justice ruled that when a corporation possesses information that is material to the value of its shares and knows that shareholders are unaware of the information, it has a duty to disclose the information. The result of the failure to disclose was that certain shareholders' interests were preferred, without any legitimate corporate interest accounting for the differential treatment. The Court ordered the defendant to compensate the plaintiffs to rectify its oppressive conduct.

Corporate / Securities Decisions and Regulatory Developments (cont'd.)

II. U.S. CASES

page 18
In Re. Pure Resources Inc.
808A. 2d 421 (Del. Ch., 2002)
Delaware Court of Chancery
(October 1, 2002)

The Delaware Court of Chancery enjoined the consummation of a tender offer by which Unocal Corporation sought to acquire all of the outstanding shares of a related company, Pure Resources Inc. Material information relevant to Pure shareholders' decision-making process had not been disclosed by Pure. In reviewing the offer, the court held that the Solomon standard of fiduciary conduct applied in this case. Unocal's offer was generally non-coercive, except for inclusion within the "minority" of those shareholders who were directors and officers of Unocal and the management of Pure.

page 20
Omnicare Inc. v. NCS Healthcare Inc. et al.
818A. 2d 914 (Del. Sup. Ct., 2003)
Delaware Supreme Court
(April 4, 2003)

The Delaware Supreme Court held that in the absence of a fiduciary out provision, an irrevocable voting agreement with a majority shareholder, combined with a force-the-vote provision in a merger agreement, is coercive and preclusive. The court also held that the merger and voting agreements were invalid and unenforceable, and enjoined the consummation of the merger between Genesis Health Ventures Inc. and NCS Healthcare Inc.

page 23
Richard Erickson v. Centennial Beauregard Cellular LLC
2003 Del. Ch. LEXIS 38
Delaware Court of Chancery
(April 11, 2003)

A company undertaking a short-form merger has the fiduciary duty to disclose to minority shareholders all information material to the decision about whether to accept the merger consideration or seek a statutory appraisal. In this case, the Delaware Court of Chancery held that there was insufficient disclosure provided to minority shareholders, particularly with regard to the valuation of the shares.

III. REGULATORY DEVELOPMENTS

page 27
BILL 198 – KEEPING THE PROMISE FOR A STRONG ECONOMY ACT (BUDGET MEASURES) - ONTARIO'S PROPOSED SECONDARY MARKET LIABILITY REGIME

Under the proposed Ontario secondary market liability regime, experts (which include an accountant, actuary, appraiser, auditor, engineer, financial analyst, geologist and lawyer) may be liable for misrepresentations in their reports, statements or opinions.

I. CANADIAN DECISIONS

Peoples Department Stores Inc. (Trustee of) v. Wise
[2003], 41 C.B.R. (4th) 225
Québec Court of Appeal
(February 5, 2003)

The Quebec Court of Appeal overturned the trial judge's ruling that directors owe duties to creditors in near-insolvency situations. The court was reluctant to link the rights of creditors with those of shareholders, even when bankruptcy was imminent. The Quebec Court of Appeal stated that extension of director liability in this context would constitute an encroachment upon the legislated regime of director liability to third parties.

(Leave to appeal to the Supreme Court of Canada granted [2003] S.C.C.A. No. 133) (Notice of appeal filed September 23, 2003).

The Quebec Court of Appeal rendered a very important decision reversing the 1998 lower court judgment in the same matter. There, certain directors had been found liable, in part, on the basis of having contravened their duty to consider the interests of creditors.

The Court of Appeal's judgment will provide support for the proposition that directors do not owe duties directly to creditors even when the subject corporation is in financial difficulty, and that courts should show deference to the business judgment of directors and not find them liable for simple errors of judgment. However, the decision does run contrary to the trend of courts in other jurisdictions to hold that there is a duty to the creditors of a corporation nearing insolvency because they are the only true stakeholders. Further, the impact of the decision on the duty of directors to creditors may be fairly limited since the decision does not deal with the oppression remedy under the Canada Business Corporations Act ("CBCA"), which expressly requires directors to consider the interests of creditors when making decisions that adversely affect their interests.

In the Superior Court decision, Mr. Justice Greenberg had found certain of the directors of Peoples Department Stores Inc. personally responsible for the losses of creditors when it went bankrupt. The directors, who served on the board of both Peoples and its parent, Wise Stores Inc., had decided to integrate the two companies' inventory procurement systems. The new system resulted in Peoples paying for certain inventory that went to the Wise stores such that Peoples was owed the cost of such inventory by the financially troubled Wise. Both Peoples and Wise were finally put into bankruptcy by Marks & Spencer and the creditors of Peoples sued its directors for breach of their statutory duties. In the trial judge's view, the directors had breached their fiduciary duties and their duties of diligence and skill.

The Court of Appeal disagreed with the trial judge's reasons for finding the directors liable and presented quite a different version of facts in certain respects. In the view of Mr. Justice Pelletier, who spoke for the court, the inventory policy

may have contributed to Peoples' financial problems, but its demise was more likely due to other problems such as the entrance of competitors like Wal-Mart into the Quebec market.

The trial judge had found that Peoples' directors had breached their fiduciary duty by preferring the interests of Wise to those of Peoples and not taking into account the interests of creditors of Peoples who, in circumstances of insolvency or near insolvency, are the only parties with a meaningful stake in the corporation. The trial judge had, however, recognized that there was no doubt the directors had acted in good faith, had derived no personal benefit from their decisions (except indirectly as the controlling shareholders of Wise) and had not acted dishonestly or fraudulently.

The Court of Appeal held that a director's duty to act in the best interests of a corporation is generally a duty to act in the best interests of the shareholders as a whole, which in Peoples' case meant the parent, Wise. In the Court's view, the fiduciary duty aspect of Section 122 of the CBCA requires a subjective test that looks to the directors' motivation in acting and not to the objective consequences of their actions, as does the duty of care. The Court of Appeal expressly disapproved of the trial judge's view that Canadian courts should follow the trend in the jurisprudence in the United States, Australia and New Zealand to hold that directors have a duty to put the interests of creditors first when the corporation is near insolvency or at risk of becoming insolvent. In the view of Pelletier J.A., this would require a legislative amendment. He noted that, in any event, any theory requiring directors to take creditors' interests into account when a corporation is insolvent or near insolvency would not be relevant in the circumstances, given that the decision to implement the inventory policy had been taken at a time when Peoples' bankruptcy was not contemplated.

In the trial judge's view, the defendant directors' decision to implement and maintain the inventory procurement policy was a breach of their duty of diligence and skill under the CBCA. The Court of Appeal stated first that the correct standard of care against which to judge directors' decisions is an objective/subjective standard which takes into account both "objective elements –embodied in the reasonable person language – and subjective elements – inherent in individual considerations like 'skill' and the idea of 'comparable circumstances.'" In the Court's view, in the absence of special circumstances (such as fraud or misrepresentation), a court should not find directors personally liable for the corporation's liabilities. Since the directors of Peoples' had been guilty, at worst, of

an "honest error of business judgment", they should not be held liable, given that they had acted in good faith. Further, since the directors had relied upon the advice of their internal financial officer, they were permitted to rely upon the defence of reliance on experts' advice set out in Section 123(4) of the CBCA. As noted above, the Court of Appeal was of the view that extending a director's fiduciary duties under the CBCA to creditors was inappropriate. In its view, the oppression remedy (which does refer to creditors) appeals to notions of equity and covers many more situations than do the statutory duties of loyalty and skill set out in Section 122(1) of the CBCA.

The trial judge had found that the inventory procurement policy constituted financial assistance by Peoples to Wise which contravened a covenant in the purchase agreement pursuant to which Wise had purchased Peoples. The Court of Appeal did not discuss the breach of the agreement but rather stated that, since there was a specific exemption or "safe-harbour" permitting financial assistance by a wholly-owned subsidiary to its parent, this should be read to provide protection to the directors' decision. Since the legislature had expressly approved such aid, it could not contravene the directors' duties. These conclusions may lead commentators and other courts to consider the Court's views on directors' duties to be of secondary importance in the decision. Nonetheless, the Court of Appeal did expressly disapprove of a general duty to creditors in the absence of legislative authority.

Saarnok-Vuus v. Teng

[2003], 31 B.L.R. (3d) 92

British Columbia Supreme Court

(February 14, 2003)

The Saarnok and Teng families had long been associated in the operation of an apartment complex near Vancouver. Saarnok and Teng were friends and 50% shareholders in the management company, incorporated under British Columbia companies law. However, problems began when the two men died, in 1996 and 2001, respectively.

The British Columbia Supreme Court ruled that the actions of one of two shareholders of a closely-held company to prevent the other shareholder from having any say in the affairs of the company were oppressive, even though the conduct was in accordance with the company's Articles. The Court held that where the alleged conduct is authorized by law, an element of bad faith must be proven in order to establish the conduct as oppressive. Where bad faith is established, the Articles cannot be used to perpetuate a situation of conflict between the shareholders that is not in the best interests of the company.

Teng's daughter, Langille, became a director of the management company on her father's death and ran the building on a day-to-day basis, getting Saarnok to sign cheques in blank where necessary. When Saarnok died, however, Langille (as sole remaining director) appointed a family friend as the second director without informing Saarnok-Vuus, Saarnok's widow. A letter from her solicitors to Saarnok-Vuus stated that this had been done in accordance with the Articles of the company, and indeed was a requirement, as the Articles specified that there be a minimum of two directors on the board.

Saarnok-Vuus was not pleased with the appointment and complained repeatedly through her solicitor. Eventually, Langille's friend was replaced by Saarnok-Vuus' accountant, but the friend remained secretary and retained signing authority, effectively allowing Langille to run the company without opposition from Saarnok-Vuus. In addition, Langille did not provide proper accounting of expenses and created a management fee for herself without notice to Saarnok-Vuus. Saarnok-Vuus' nominee director resigned in frustration and once again, Langille appointed her friend, without notice, to fill the vacancy.

As a result, Saarnok-Vuus brought the oppression application under the British Columbia Company Act. Langille argued that this was a case of "no-fault deadlock" that justified leaving those involved in the daily management of the business (i.e. her) to continue in that role.

Madam Justice Ross held that Langille's conduct had indeed been oppressive. The interesting question was whether it mattered that the appointment of Langille's friend as director – the main act complained of – had technically been in accordance with the company's Articles. This came after an extensive discussion of the significance of good faith and bad faith in oppression remedy cases. While the

law on this point, at least in British Columbia, seems uncertain, Ross J. seems to have preferred the view that where the complained-of act was legally authorized, bad faith should be shown; while where the act was not legally authorized, it may not, in the right circumstances, be necessary to show bad faith.

In this case, the act was not contrary to the Articles, but was also not in good faith:

> …the technicalities of the Articles were utilized to shut out Ms. Saarnok-Vuus and to perpetuate the situation of conflict in which Ms. Langille had placed herself, a situation that is clearly not in the best interests of the company.

On the same theme, Ross J. noted:

> …a combination of acts any one of which alone may not constitute oppression or unfair prejudice, may in their totality be found to do so.

Ross J. also found that it did not matter that Langille had carried on in much the same way for the last years of old Mr. Saarnok's life. Finally, Ross J. also found the conduct to have been "unfair and prejudicial" to Saarnok-Vuus, which is another criterion in the oppression section of the Company Act.

Langille's family was ordered to offer to sell their shares to Saarnok-Vuus.

Vlasblom v. NetPCS Networks Inc.

[2003], 31 B.L.R. (3d) 255

Ontario Superior Court of Justice

(February 20, 2003)

Vlasblom had been Vice President, Finance of NetPCS Networks Inc., a company that initially attracted a fair amount of venture capital financing, but that went out of business in 2002. Vlasblom complained of a "pattern of oppression" on the part of the company's management. The main element in the pattern was an issuance of shares to the company's founders and, by way of debenture conversion, to its main investor, the venture capital fund TechnoCap. Both of these share issuances had allegedly diluted Vlasblom's interest as a shareholder. Other allegedly oppressive acts included his demotion and firing and his having been promised, but not delivered, stock options vesting immediately upon his hiring. Instead he was merely enrolled in the general employee stock participation program ("ESPP"), under which shares acquired did not vest for two years. This summary focuses on the first issue raised in the claim.

The plaintiff was an employee of the defendant company and alleged that the conversion of previously issued debentures to common shares by a venture capital firm, and the issuance of further shares to key executives for nominal consideration, was tantamount to oppression. The Court dismissed the action, finding that the issuance of the shares was necessary to facilitate a financing required to keep the company in business. The issuances and any consequent dilution of the shares held by the plaintiff were found to be in the best interests of the company.

TechnoCap had been the only significant investor in the company. It held 49.99% of the common shares to allow the company to qualify for "Canadian-controlled private corporation" ("CCPC") tax status, but had also negotiated the issuance by the Company of "participating debentures" that gave TechnoCap a stranglehold on the company's future growth. In early 2000, a major new financing took place involving TechnoCap and a number of other parties. These investors did not wish to be subordinated to the participating debentures, so TechnoCap agreed in November 1999 that some of the debentures should be converted into common shares. The problem, from Vlasblom's point of view, was that the debentures had a face value of $18,504 while the common shares issued on the conversion totalled 1,850,400, amounting to a price of 1/100¢ per share. In addition, the founders received about 1.4 million shares between them at the same price, in recognition of their work as founders and as incentive to remain with the firm.

The defendants argued that Vlasblom could not claim a remedy under the oppression provisions of the CBCA because he was not a shareholder at the time of the 1999 agreement. He had been issued the share certificate on taking the job but, in accordance with an understanding with the company, had not yet actually paid for the shares. Citing an earlier decision, Polowin J. disagreed stating that all that was required to bring a claim is that the claimant be a "beneficial owner" of shares, which, the Court said, should be construed broadly.

Central to the issues raised in the case were the 1999 share issuances. Vlasblom's counsel argued that share issuances must be made in good faith, failing which a Court should hold them to be oppressive. Counsel argued that to convert participating debentures worth $18,504 into 1.8 million shares in anticipation of a financing that valued the company at slightly over $2 per share was oppressive to Vlasblom. The Court held that it was necessary to look at more than the face value of the debentures since they had been issued when NetPCS was on the verge of failing. They were intended as a proxy for common shares, because of the necessity of maintaining CCPC status, allowing TechnoCap to participate fully in the growth of the company.

Moreover, the Court found that the conversion did not dilute Vlasblom's interest because there had always been a possibility of conversion and the Court did not accept Vlasblom's testimony that he had been assured that this wasn't possible. Finally, it was significant that there was a clear business reason for allowing the conversion, namely, the priority concerns of the new investors.

Polowin J. found that there was a good faith business purpose for transferring shares at a discount to the two founders. A number of interesting points were made in this connection:

- The Court accepted that it is "the ordinary practice, in the environment of a start-up corporation, to provide incentive to key employees by the granting of shares, sometimes at preferred or even nominal rates, to reward for accomplishments or to ensure future commitment to the company."

- The founders had not received the additional shares as shareholders or directors, but as employees whose services the new investors wished to retain.

- Polowin J. accepted that it was legitimate for a company to give shares to key employees if this helped to secure additional investment by convincing potential investors that the employees had "sufficient 'skin in the game' to ensure that they were committed to staying with the company."

- The Court found that the 18% of fully diluted shares that the two founders held between them, after receiving the additional shares, was "appropriate and reasonable" for an early-stage start up.

Because the employees of NetPCS were also shareholders, the company needed them to sign the documentation for the financing, which included the 1/100¢ per share transaction for the founders that was not offered to the other shareholders. A party was arranged around Christmas 1999 at which a speech was given about the importance of the financing to the company. Employee-shareholders were then instructed to sign the subscription documentation, which they, including Vlasblom, did.

Polowin J. agreed with Vlasblom that the circumstances of the subscription were not entirely proper. Simply putting the documentation in the room while the party was taking place "as if the employees would be informed by its very presence" was insufficient. However, Polowin J. held that the secrecy surrounding the agreement did not on its own support a claim for oppression.

Even if oppression had been found, Polowin J. added, she would have declined to grant the remedy because oppression is a discretionary remedy meant to rectify and not to punish. In this case, there had been no market for NetPCS shares at the time of the alleged oppression, so the "oppressors" did not profit and Vlasblom did not lose as a result of the issuances. Reinforcing this conclusion was the fact that the ESPP did not commit NetPCS to purchase a departing employee's shares, so the Court rejected Vlasblom's claim, which was based partly on the value he would have received had he exited the company with the larger holding to which he felt entitled.

Most of Vlasblom's claim was actually for lost wages and commissions relating to his demotion and eventual firing, but Polowin J. considered all of the employment issues to be subsidiary to the issue surrounding the share subscriptions. Polowin J. indicated that she was influenced by recent jurisprudence that seemed to suggest that the courts will not allow the growing masses of employee-stockholders to turn wrongful dismissal actions into oppression actions.

Dylex Ltd. (Trustee of) v. Anderson
[2003] 63 O.R. (3d) 659
Ontario Superior Court of Justice
(March 11, 2003)

The former directors and senior officers of Dylex Ltd. brought motions to strike oppression and breach of fiduciary duty claims asserted by the trustee in bankruptcy of Dylex on behalf of creditors, arguing that the trustee did not have the legal capacity to bring such claims. Noting that the law on the subject remained unsettled, the Court rejected the directors' motions on the grounds that the trustee was akin to a representative of the creditors and their interests, and in this role, the trustee was the proper party to assert the oppression and breach of fiduciary duty claims.

Dylex was a decision on two motions by former directors and officers of Dylex Ltd. While in denying the motions, Mr. Justice Lederman did not decide any substantive issues, he did appear to attach considerable weight to the plaintiffs' argument that the trustee in bankruptcy was a representative of creditors and could proceed with actions alleging oppression and breach of fiduciary duty against certain of the company's former directors and officers.

The motions sought to strike out various sections of the statement of claim issued by Dylex's trustee in bankruptcy. These included the trustee's oppression claim, its breach of fiduciary duty claim and the further claim that the defendants were responsible, on the grounds of their misconduct, for $20 million of losses suffered by Dylex after it was taken over by Hardof Wolf Group Inc. ("HWGI").

With respect to the first two claims, the defendants argued that the trustee lacked capacity to bring the claim. With respect to the third, they argued (i) that they had had no duty to conduct investigations into the moral character and background of HWGI, and (ii) that the losses had occurred after they had resigned from the board. Thus, the defendants argued, the trustee's arguments could not succeed and should be struck out under the rules of the Court.

The defendants had two main arguments with respect to the trustee's allegations under the Canada Business Corporations Act (the "CBCA") oppression provisions:

(1) The trustee could not bring a claim for oppression because the trustee had no greater rights in this respect than the corporation itself and a corporation could not be oppressed by the acts of its own directors, which are by definition its own acts.

This proposition was affirmed by Houlden J. in *Canada (Attorney General) v. Standard Trustco* (1991), 5 O.R. (3d) 660, on the grounds that actions taken and approved by directors of a company become actions of the corporation itself. Since a company cannot sue itself, a trustee in bankruptcy (i.e. a representative of the company) cannot sue the company either, absent explicit statutory authority to do so. However, this proposition has been questioned or rejected in other decisions, notably *Gainers Inc. v. Pocklington* (1992), 7 B.L.R. (2d) 87 (Alta. Q.B.) and by Farley J. in *O&Y Developments Ltd. (Trustee of) v. Olympia & York Realty Corp.* [2001] O.J. No. 3394 (S.C.J.). These two rulings stated that in a proper case, a trustee in

bankruptcy may qualify as a complainant in an oppression remedy proceeding. Lederman J. seemed to favour this idea, going beyond merely acknowledging its plausibility in commenting:

> Farley J.'s ruling is predicated on the well recognized role of the trustee in bankruptcy as a representative of the creditors. Moreover, it is consistent with the plain language and spirit of Section 238 of the CBCA which defines a "complainant" to include "any other person who in the discretion of a court is a proper person to make an application under this part."

(2) The defendants' second argument against the oppression claim was that the right to relief from oppression is a personal remedy and cannot be exercised, by statute or otherwise, by a trustee in a representative capacity.

Lederman J. noted that (i) Farley J.'s ruling in O&Y is "predicated on the well recognized role of the trustee in bankruptcy as a representative of the creditors", (ii) Section 238 gives the court discretion to hear a claim from any person whom the court considers "proper", (iii) the CBCA implies that proceedings in oppression cases can be representative in nature, and (iv) that trustees are not limited to the remedies available under the Bankruptcy and Insolvency Act.

Thus, according to Lederman J., quoting the test for dismissing a claim, it was far from "plain and obvious" that the defendants were correct in their contention that the trustee's oppression allegations were not valid.

While acknowledging the appellate decision in *Peoples Department Stores v. Wise* [2003] 41 C.B.R. (4th) 225, Quebec Court of Appeal (see separate summary), Lederman J. noted that "it remains to be seen whether [the *Peoples* case] will be followed in other jurisdictions or whether other Canadian courts will follow the lead of the British, Australian and New Zealand courts." For reasons similar to those he raised with respect to the oppression claim, Lederman J. decided that it was not "plain and obvious" that a trustee cannot act in a representative capacity in asserting a fiduciary duty claim on behalf of creditors, and declined to dismiss the claim.

The trustee alleged that the defendants had breached various duties before resigning which had led to the acquisition by HWGI, and the losses to Dylex that were alleged to have occurred as a result of that acquisition. Lederman J. held that the determination of whether a breach of duty had occurred "may or may not" include "a thorough investigation into the background and affairs of the potential inquiror". The resolution of this interesting issue depended on a thorough consideration of the facts that could not be undertaken at the motions stage and should wait for the evidence presented at trial.

The plaintiffs asked that the Court order a sale of the defendants' shares at a price less than their assessed value, claiming that negative adjustments should be made because of the actions of one of the shareholders. The B.C. Supreme Court declined to do so and reasserted the fundamental principle that a company and its shareholders are distinct entities, with independent rights and obligations.

Pasnak v. Chura
[2003] B.C.J. No. 1591
British Columbia Supreme Court
(July 2, 2003)

The parties were seeking to end their business relationship, but were unable to agree on a purchase price for the shares of the relevant companies. The plaintiffs, Allen Pasnak, and his personal holding company Double J Investments Ltd., and the defendants, Norman Chura and his personal holding company Chura Holdings Ltd., were the directors and equal shareholders of four companies: Summit Motors Ltd. (a Mazda dealership); Summit Leasing Ltd. (the registered owner of the property on which Summit Motors operated); Fleetwood Motors Ltd. (which used to operate the Mazda dealership until 1998); and Summit Investments Ltd, (the registered owner of the property on which Fleetwood used to operate). Mr. Pasnak managed Summit Motors, and Mr. Chura had managed Fleetwood when it was in operation.

An independent valuation of the companies conducted pursuant to a Court order found that if there were no adjustments to be made to Mr. Chura's share value, the cost to Mr. Pasnak of Mr. Chura's shares should be $1,321,697. The plaintiffs sought negative adjustments reducing the figure by over a million dollars to $282,836. The plaintiffs alleged numerous breaches of duty by Mr. Chura in his operation of Fleetwood, including oppression against Double J as a shareholder, negligence, breach of fiduciary duty to Mr. Pasnak as co-director, breach of a shareholders' agreement with Mr. Pasnak, and breach of partnership duties. The plaintiffs also asked that the Court use its broad powers under Section 200 of the B. C. Company Act to reduce the purchase price from the assessed value.

The B.C. Supreme Court agreed that the four companies should be wound up because of the deadlock which existed between Mr. Chura and Mr. Pasnak, but, with one minor exception, refused to adjust the purchase price from the accountant's valuation. The Court concluded that Section 200 only gave it powers within the existing causes of action and held it could not fashion any relief it wanted, if that implied going outside existing restrictions in law.

The Court rejected the plaintiffs' argument that it could use its wide powers under Section 200(2) to remedy the oppression of Mr. Chura against Double J. The Court agreed with the defendants that a loss to the shareholder of share value which is merely consequential or incidental to a loss suffered by the company itself must be the subject of a derivative action by the company for its loss. Since Double J could not show any loss other than to its share value in Fleetwood, they were properly company claims for Fleetwood to bring, and not oppression claims of Double J.

The Court also noted an additional "insurmountable" hurdle in this case. The actions of Chura were alleged to have oppressed Double J in the operation of Fleetwood and not in the operation of any of the other three companies. However, the value of Chura's shares in Fleetwood was nil, and all the value in Chura's shares were in the other three companies. The Court found that there was no legal authority to impose the consequences of oppression in one company on the purchase price of the shares of the oppressor in other companies where there was no oppression.

The Court also noted that the old common law derivative action had been superseded and replaced by the statutory derivative action under Section 201 of the B.C. Company Act, and the common law right of a shareholder to claim on behalf of the company (which was essentially what Pasnak was trying to do) no longer existed.

The plaintiffs' next argument related to various common law personal rights. First, the plaintiffs claimed on behalf of Mr. Pasnak, as a director of Fleetwood, against Mr. Chura, as a fellow director, for negligence. The Court held that, as in oppression, there is a requirement for special damage to the *individual* apart from damage to the company in order for relief to be available. Here, there was no evidence that Mr. Pasnak was exposed to any separate and distinct personal damage. The allegations of breach of fiduciary duty on the part of Mr. Chura, as a director of Fleetwood, to Double J, as the shareholder of Fleetwood, and to Mr. Pasnak, as a co-director, were dismissed for lack of evidence. Similarly, the Court did not find sufficient evidence to support the allegations of breach of contract.

Lastly, the plaintiffs argued that the relationship between the parties was really one of partnership even though they carried on their business relationship through incorporated companies, and that this relationship obliged Mr. Chura to account to Mr. Pasnak as a partner for personal benefits that he had taken from the business of the partnership. The Court found that the relationship between the parties was that of equal shareholders in the four companies, and that there was no legal partnership per se between the parties. As such, their rights were to be determined by applying company law principles and not partnership principles.

Applying these conclusions, the Court considered the various negative adjustments sought by the plaintiffs. The plaintiffs had claimed the value of preferred shares of Double J in Fleetwood against the defendants, as Fleetwood was now worthless. The Court characterized this as a claim against Fleetwood, which could no longer be met; the defendants, being distinct legal entitles from Fleetwood, were not personally liable for these claims. Other claims were rejected as properly belonging only to Fleetwood: the plaintiffs could not claim for legal costs paid by Fleetwood while it was being operated by the defendants, nor for the value of vehicles owned by Fleetwood and used by the defendants. The only point on which the plaintiffs were successful was in claiming for half the amount owed by Mr. Chura on his personal account to Fleetwood. The Court therefore ordered that the plaintiffs be permitted to purchase all the shares of the defendants in the four companies for the original amount assessed, less $19,500, for a total of $1,302,197.

Harding v. First Associates Investments Inc.
[2003], O.J. No. 3220
Ontario Superior Court of Justice
(August 14, 2003)

The Ontario Superior Court of Justice ruled that when a corporation possesses information that is material to the value of its shares and knows that shareholders are unaware of the information, it has a duty to disclose the information. The result of the failure to disclose was that certain shareholders' interests were preferred, without any legitimate corporate interest accounting for the differential treatment. The Court ordered the defendant to compensate the plaintiffs to rectify its oppressive conduct.

The plaintiffs in this case were former shareholders of the defendant, First Associates Investments Inc. The plaintiffs sought an order using the oppression remedy under Section 248 of the Ontario Business Corporations Act. They argued that the amounts they were paid by First Associates for their shares did not adequately reflect their fair market value. The Court reiterated that the oppression remedy was a statutory equitable remedy, intended to protect the reasonable expectations of shareholders or other complainants, and that reasonableness was to be determined objectively.

Three of the four plaintiffs were actually directors of First Associates. The assets in question were shares in Toronto Stock Exchange Inc. (the "TSX") that were acquired in exchange for a stock exchange seat as a result of the demutualization of the TSX. The Court found that, while the plaintiffs knew about the TSX demutualization, the exchange of the Company's seat for shares in a private company and that at the time First Associates' shares were sold any increase in value resulting from the demutualization had already occurred, only certain Directors knew about a valuation of the shares conducted by KPMG and that the TSX shares would increase in value.

In the Court's view, First Associates did not take appropriate action to deal with the valuation of shares it held, despite the fact that it had received information that was clearly material. The shares were estimated to be worth more than fifty times the amount that was recorded on First Associates' books. As a result of this inaction, the plaintiffs were not aware that their First Associates shares might be worth much more than they were valued when they sold their shares to First Associates. First Associates was aware that shareholder transactions were taking place, and that transfers would negatively affect sellers and positively affect buyers, since the shares were undervalued and still appreciating.

Mr. Justice Sanderson held that First Associates used the corporate machinery for the benefit of shareholders who bought shares that were valued "obviously and materially" below fair market value, thereby unfairly and without justification preferring the interests of those shareholders over the plaintiffs' interests. The defendant had a duty to disclose information material to the value of the shares that it knew the plaintiffs were not aware of. The Court confirmed the standard of "adequate and appropriate disclosure" which was approved in *Arthur v. Signum Communications Ltd.,* [1991] O.J. No. 86 (Gen. Div.).

Mr. Justice Sanderson also ruled that the business judgment rule could not be used to justify the prejudicial treatment of minority shareholders, or to shield improper conduct. Once First Associates knew that it held an asset that might have material value above its book value, it was contrary to the reasonable expectations of the shareholders that they took no action. The Court found that there was no business need to abstain from action, and that something could and should have been done after they became aware of the possible discrepancy.

Lastly, the Court did not allow First Associates to rely on a provision in the First Associates shareholders' agreement which required shareholders to request an independent valuation by the auditors. Instead, the Court held that First Associates was required to disclose all material information. The Court considered that First Associates might have needed some time to consider its options, but that it could have eventually taken action retroactively in order to remedy the situation.

II. U.S. CASES

In Re. Pure Resources Inc.
808A. 2d 421 (Del. Ch., 2002)
Delaware Court of Chancery
(October 1, 2002)

The Delaware Court of Chancery enjoined the consummation of a tender offer by which Unocal Corporation sought to acquire all of the outstanding shares of a related company, Pure Resources Inc. Material information relevant to Pure shareholders' decision-making process had not been disclosed by Pure. In reviewing the offer, the court held that the Solomon standard of fiduciary conduct applied in this case. Unocal's offer was generally non-coercive, except for inclusion within the "minority" of those shareholders who were directors and officers of Unocal and the management of Pure.

Pure Resources Inc. ("Pure"), an oil and gas company, is a combination of Titan Exploration Inc. ("Titan") and a spin off of one of Unocal Corporation's ("Unocal") units. Unocal owned 65.4% of Pure's issued and outstanding common shares. Titan's former shareholders, including its managers who continued to run Pure, held 34.6% of the company. Pure's management controlled about one third of the company's stock not already owned by Unocal.

At the time of Pure's creation, the following contracts were concluded: (i) Pure agreed not to compete with Unocal in certain designated geographic areas, (ii) Unocal obtained a non-dilution agreement from Pure, and (iii) members of Pure's management signed put agreements with Unocal triggered by, among other events, the acquisition by Unocal of 85% of Pure's shares.

Pure's chief executive officer, who apart from Unocal, was the company's largest shareholder, sought to aggressively expand operations by selling a portion of Pure's mineral rights to third parties (the "Royalty Trust"). The Royalty Trust plan put pressure on Unocal to acquire the portion of Pure that it did not already own. As such, Unocal tendered a share exchange offer to Pure. Unocal's offer represented a 27% premium on the closing price of Pure's common shares on the date of the offer. Following the offer, Pure's board established a special committee, which ultimately did not recommend the offer.

Given that a controlling shareholder sought to acquire the remainder of a corporation's shares, the court had to consider the appropriate standard of fiduciary conduct. However, two lines of Delaware cases conflicted on the appropriate standard of review. The court observed that the lines of cases treated economically similar transactions as categorically different, simply because the approach taken by the controlling shareholder differed. The court sought to resolve the doctrinal tension.

The first line of authority is the Delaware Supreme Court's view (*Kahn v. Lynch Communication Systems Inc.* (638 A.2d 1110 (Del. 1994)) that where a controlling shareholder attempts to acquire the remaining shares in a negotiated merger, the courts should apply a stringent "entire fairness" review regardless of whether: (i) the target board was comprised of a majority of independent directors, (ii) a special committee of the target's independent directors was empowered to

negotiate and veto the merger, and (iii) the merger was made subject to the approval by a majority of the disinterested target shareholders. Notwithstanding these protections, the court held that there is inherent coercion whenever a controlling shareholder seeks to buy the minority's shares. Kahn continues to govern negotiated mergers between controlling shareholders and subsidiaries.

The second line of authority (*Solomon v. Pathe Communications Corp.,* 672 A.2d 35 (Del. 1996)) applies to non-coercive tender offers made by a controlling shareholder. In such offers, the courts should not impose any right of shareholders to receive a particular price. However, the offer must be free of coercion, and there must be no materially false or misleading disclosures made to shareholders to the offer.

The Delaware Court of Chancery was not satisfied that the distinction between the foregoing lines of authority could be justified on the basis of technical differences between tender offers and negotiated mergers. The court concluded that it was preferable to apply the more flexible *Solomon* standard and at the same time take into account concerns of inherent coercion and structural bias.

The *Solomon* standard does not eliminate the fiduciary duties of controlling shareholders or target boards in connection with tender offers made by controlling shareholders. Rather, a tender offer by a controlling shareholder is non-coercive only when: (i) it is subject to a non-waivable majority of the minority tender condition, (ii) the controlling shareholder promises to promptly consummate the short form merger at the same price if it obtains over 90% of the shares, and (iii) the controlling shareholder has made no retributive threats.

Further, the majority shareholder owes a duty to allow independent directors on the target board adequate time and freedom to react to an offer. The independent directors should be free to hire their own advisors, provide the minority with a recommendation as to the advisability of the offer, and disclose adequate information so that the minority can make an informed judgment. The independent directors have a duty to undertake these tasks in good faith and diligently, and to pursue the best interests of the minority. However, where the offer is non-coercive, there is no duty of the controlling shareholder to permit the target board to block the bid through the use of a poison pill. Nor is there a duty on the independent directors to seek blocking power.

The court concluded that Unocal's offer was coercive because it included in the definition of "minority", shareholders affiliated with Unocal as directors and

officers, as well as the management of Pure. The incentives for these shareholders were skewed by their put agreement, as well as their employment and severance agreements. Aside from this "readily curable" problem (which could be cured by amending Unocal's offer and making it conditional on the approval of a majority of Pure's unaffiliated shareholders), the court held that the offer was non-coercive.

The court also found that the Pure board did not meet the requisite standard of disclosure to shareholders. Pure shareholders were entitled to the disclosure of all material facts pertinent to the their decisions. Pure failed to disclose the investment bankers' analyses, which deprived shareholders of important information to make an informed decision about whether the exchange rating was favourable to them. Pure also omitted to disclose the potential liability of two Pure directors (who were also officers and directors of Unocal) for potential future breaches of Pure's non-competition agreement with Unocal. Finally, Pure did not disclose the Royalty Trust transaction, which was material on account of its impact on Pure if the offer was not successful. The court found, however, that there was no obligation of a controlling shareholder to reveal its reserve price in either a negotiated merger or a tender offer situation.

Based on a balance of harm analysis, the court granted the preliminary injunction.

Omnicare Inc. v. NCS Healthcare Inc. et al.
818A. 2d 914 (Del. Sup. Ct., 2003)
Delaware Supreme Court
(April 4, 2003)

The Delaware Supreme Court held that in the absence of a fiduciary out provision, an irrevocable voting agreement with a majority shareholder, combined with a force-the-vote provision in a merger agreement, is coercive and preclusive. The court also held that the merger and voting agreements were invalid and unenforceable, and enjoined the consummation of the merger between Genesis Health Ventures Inc. and NCS Healthcare Inc.

NCS Healthcare Inc. ("NCS"), a provider of pharmacy services to long-term care facilities, was in financial difficulty as a result of adverse market conditions. By early 2001, NCS' market capitalization had declined precipitously and the company had defaulted on US$350 million in debt. NCS began to explore strategic alternatives to address its problems, and subsequently entered into discussions with Omnicare Inc. ("Omnicare") about a possible merger and solicited a proposal from Omnicare in that respect. Omnicare was initially only interested in an asset sale in bankruptcy. NCS approached Genesis Health Ventures Inc. ("Genesis"), a competitor of Omnicare with a history of bitter rivalry towards Omnicare. When a deal outside the bankruptcy context between NCS and Genesis became a real possibility, Genesis sought several deal

protection devices, including an exclusivity agreement and irrevocable voting agreements with the majority shareholders. NCS' independent committee believed that Genesis's proposal was superior to Omnicare's proposal. NCS therefore entered into a merger agreement with Genesis which included the following terms: (i) NCS' board was required to submit the tender offer to shareholders for a vote, regardless of whether NCS' board continued to recommend the merger, and (ii) NCS' director-shareholders, who constituted a majority of NCS shareholders, were required to enter into irrevocable voting agreements to support the merger. The foregoing terms virtually guaranteed approval of the merger.

Following the Genesis proposal, Omnicare made a new offer to acquire NCS (outside the bankruptcy context), which was economically more favourable than the Genesis bid. However, among other things, Omnicare's bid was subject to their completion of due diligence. NCS' independent committee subsequently used Omnicare's offer to negotiate better terms with Genesis, and Genesis agreed on the condition that the transaction be approved immediately. Both NCS' independent committee and the NCS board approved the Genesis proposal. Omnicare then sought an injunction to prevent the consummation of the merger, and dropped the due diligence requirement, irrevocably committing itself to the transaction and thus making its offer superior to that of Genesis. As a result, NCS' board withdrew its recommendation of Genesis's bid and recommended that shareholders reject the Genesis bid in favour of Omnicare's superior proposal.

The Chancery Court held that the decision to approve the Genesis merger was not subject to *Revlon* duties because the transaction did not result in a change of control and because there had been no active bidding process. The Chancery Court applied a business judgment standard and found that the NCS board had not breached its duty of care in approving the Genesis merger. Applying the Unocal standard of "enhanced scrutiny", the Chancery Court held that the combination of a "force-the-vote" provision in the merger agreement and irrevocable voting agreements were reasonable.

Both the *Revlon* and *Unocal* standards require directors to act in the best interests of the corporation. The *Unocal* "enhanced scrutiny" standard requires directors to demonstrate that they had reasonable grounds to reject a take-over bid, and that their actions were reasonable in relation to the threat (*Unocal Corp. v. Mesa Petroleum Co.,* 493 A.2d 946 (Del. S.C. 1985)). Once a take-over or

change of control is inevitable, *Revlon* forbids directors from acting in a way that may inhibit the change of control and requires directors to supervise the transfer and maximize shareholder value (*Revlon v. MacAndrews & Forbes Holdings,* 506 A.2d 173 (Del. S.C. 1985)).

On appeal to the Delaware Supreme Court, the majority view of the Supreme Court was not to revisit the Chancery Court's business judgment rule analysis, as it was not considered determinative of the appeal. Rather, the Supreme Court focused on the defensive measures and applied the *Unocal* enhanced scrutiny analysis. Pursuant to the first stage of the enhanced scrutiny standard, NCS' directors were required to show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed. To satisfy this burden, NCS' directors were required to show that they acted in good faith after conducting a reasonable investigation. In this case, the NCS board identified the threat as the possibility of losing the Genesis offer and being left without an alternative, comparable transaction.

At the second stage of the enhanced scrutiny analysis, NCS' directors were required to prove that their defensive response was reasonable in relation to the threat. The directors had to prove that the defensive measures were not coercive or preclusive, and that their response was within the range of reasonable responses to the threat. A response is "coercive" if it is aimed at forcing upon shareholders a management-sponsored alternative to a hostile bid. A response is "preclusive" if it deprives shareholders of the right to receive all tender offers or precludes a bidder from seeking control by fundamentally restricting proxy contests or otherwise.

The Supreme Court held that the defensive measures employed by NCS' board (as described above) were designed to coerce the consummation of the Genesis merger and preclude the consideration of any other transaction. As such, these defensive measures were held to be unenforceable. The Supreme Court held, in the alternative, that the defensive measures were unenforceable because they prevented the directors from discharging their fiduciary duties to minority shareholders. The board was required to negotiate a "fiduciary out". The absence of a fiduciary out, taken in combination with the lock-up and force-the-vote provisions, violated the director's fiduciary duties to the minority. The Supreme Court therefore granted the injunction.

However, a minority of judges of the Supreme Court dissented. They held that a director's good faith decision should not be subject to hindsight analysis, but should be subject to a review based on existing circumstances. Moreover, the minority's opinion was that lock-up agreements should be considered in the context of the entire bidding process and not in a vacuum. As a matter of business judgment, given the due diligence condition of Omnicare's offer, the minority believed that the risk of losing Genesis's bid outweighed the potential benefits of negotiating with Omnicare. The minority also believed that the lock-up was a necessary condition of any deal with Genesis and that the majority had misapplied the concept of "coercive" and "preclusive" measures. Finally, the minority emphasized that this was not a case where the board had unilaterally adopted the defensive measures.

Richard Erickson v. Centennial Beauregard Cellular LLC
2003 Del. Ch. LEXIS 38
Delaware Court of Chancery
(April 11, 2003)

A company undertaking a short-form merger has the fiduciary duty to disclose to minority shareholders all information material to the decision about whether to accept the merger consideration or seek a statutory appraisal. In this case, the Delaware Court of Chancery held that there was insufficient disclosure provided to minority shareholders, particularly with regard to the valuation of the shares.

Erickson, a minority shareholder of Alexandria Cellular Licence Corporation ("ACLC") and plaintiff in this action, challenged the valuation information provided to the minority stockholders of ACLC relating to its "short-form" merger (as described below) with Alexandria Corporation ("Alexandria"). Centennial Beauregard Cellular LLC ("Centennial"), the defendant, is the successor resulting from the merger of Alexandria and ACLC. Three years after the close of the ACLC-Alexandria merger, Erickson alleged that Centennial breached its fiduciary duty of disclosure and argued that the valuation materials provided by Alexandria in connection with the short-form merger provided little or no substantive information about the merger.

Under *Delaware General Corporation Law*, a "short-form" merger is essentially a unilateral act by a parent company to extinguish the minority shareholdings of a 90% (or greater) owned subsidiary. Such process is provided for in Section 253 of the *Delaware General Corporation Law*, which authorizes a summary procedure that does not anticipate fair dealing. For example, (i) shareholders do not vote upon such a merger, (ii) negotiation does not occur, and (iii) advance notice is not required. The only decision a minority shareholder makes in the context of a short-form merger is whether to accept the merger consideration or to seek a statutory appraisal. Although there is no necessity for entire fairness in short-

form mergers, corporate fiduciaries must fully disclose all material information related to the merger so that minority shareholders can make their decision.

In November 1999, each of the fourteen ACLC minority shareholders were notified that Alexandria intended to complete a short-form merger and that the shareholders could elect to receive US$1,650 in cash per share for their shares or seek a statutory appraisal. Included with the notice was a one-and-a-half page document entitled "Valuation of Alexandria Cellular Licence Corp." (the "Valuation"), which was intended to support the US$1,650 price per share. The Valuation contained a brief description of the enclosed "Recent Transaction Analysis" and "Discounted Cash Flow Analysis" along with two charts. The first chart listed recent transactions completed by other cellular companies, their transaction values and their "Multiple of Trailing 12 Mo. EBITDA". The second chart listed ACLC's calculated current value based on the net present value of the company's future anticipated cash flows. Both of these valuation methodologies were calculated by relying on ACLC's calculated 1999 EBITDA, which was provided to shareholders. However, the 1999 EBITDA was for an unspecified period of time, and although it purported to represent 1999 financials, the figure was provided in October of 1999 – before the year had ended. The Valuation did not provide any financial statements nor any description of ACLC's business, despite the fact that it was a private company with very little publicly available information. After receiving these materials, Erickson tendered his ACLC shares and received approximately US$80,000 in cash.

Three years after tendering his shares, Erickson filed a complaint against Centennial alleging that it breached its fiduciary duty of disclosure by providing little or no substantive information in connection with the merger. Erickson contended that ACLC's minority shareholders should have received, at a minimum (i) ACLC's current and historical financial statements, (ii) a description of the business and prospects of ACLC, (iii) the population of the region covered by ACLC's licence, and (iv) other miscellaneous data related to the Valuation of ACLC.

As noted above, the fiduciary duty of disclosure applies in a short-form merger, despite the lack of necessity for entire fairness. Where the only choice for the minority stockholders is whether to accept the merger consideration or seek a statutory appraisal, stockholders must be provided with all factual information that is material to their decision. The court began its analysis by setting out the

standard for materiality in Delaware, which is the same as that delineated by the United States Supreme Court in *TSC Industries, Inc. v. Northway, Inc.,* 96 S. Ct. 2126 (1976). Under this test, an omitted fact is material if there is a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. In other words, if disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available. The court noted, however, that omitted facts are not material simply because they might be helpful.

The court did not pass judgment on the merits of the case. Rather, in applying the materiality test to the facts, the court denied Centennial's motion to dismiss Erickson's case for failure to state a claim upon which relief could be granted. In doing so, the court found that Erickson stated sufficent facts in his claim that could entitle him to relief.

The court based its decision on Centennial's failure to provide (i) any basic financial material upon which the minority shareholders could make an informed judgment about ACLC's value, (ii) any information about ACLC's business, operations, plans and prospects, (iii) the population of the region covered by ACLC's cellular licence, and (iv) further explanation of the purported value of ACLC provided to shareholders in the Valuation, as such information could have significantly altered the "total mix" of information.

The court noted that Centennial's failure to provide shareholders with ACLC's current and historical financial statements, left shareholders with no objective market data upon which to measure the fairness of the proposed merger consideration. No information was provided relating to ACLC's revenue streams, levels of working capital, or any other financial information that would permit a shareholder to perform even the most basic financial ratio analysis. It was not sufficient for Centennial to provide only ACLC's EBITDA over an unspecified period of time, and to base the only calculations provided in the Valuation on the same EBITDA.

Centennial should have also provided information about ACLC's business, operations, plans and prospects. The court noted that some indication of business revenue projections were necessary (even in the short-form merger context) for shareholders to determine whether they would be receiving a fair price for their shares. This is because shareholders are entitled to be paid for

their proportionate interest in the company as going concern, rather than its liquidation value. The information provided in the discounted cash flow analysis in the Valuation was not sufficient to discharge Centennial's duty to disclose. Shareholders should not have to perform sophisticated financial calculations, derived from cash flow analyses provided without any underlying information, in order to figure out management's view of the company's future business. The failure to provide such information was particularly important in this case because ACLC was a private company and the shareholders did not have access to the same level of information generally afforded to shareholders of public companies.

Information about the population of the region covered by ACLC's cellular licence was also necessary. Such information is the industry standard for valuing cellular licence businesses and with it, the shareholders could have made their own calculation about the "per-pop" valuation to determine whether they would be receiving a fair price for their shares.

Finally, the court noted that the valuation analysis presented to the minority shareholders in the Valuation was so devoid of actual information that, although all of the requested information may not have been required, Centennial had a duty to provide at least some further indication of ACLC's value to its shareholders. A single number (EBITDA) purporting to encompass the value of ACLC that was not supported with any financial information is not sufficient, as a matter of law. Centennial should have provided further explanation of the EBITDA, including the derivation of revenues, allocation of expenses and the basis for selecting the EBITDA multiple, as such information would have been material to the minority shareholders' decision.

III. REGULATORY DEVELOPMENTS

BILL 198 – ***KEEPING THE PROMISE FOR A STRONG ECONOMY ACT (BUDGET MEASURES) – ONTARIO'S PROPOSED SECONDARY MARKET LIABILITY REGIME***

On April 7, 2003 the first of the *Securities Act* (Ontario) amendments included in Bill 198 took effect. Such principal amendments can be summarized as follows:

- Increased penalties for contravention of Ontario securities laws – maximum penalties for contravention of Ontario securities law fines of up to $5 million (previously $1 million) or imprisonment of up to five years (previously two), or both. An administrative penalty of up to $1 million and a "disgorgement" remedy are also now available to the OSC, in addition to reprimands, losses of exemptions, and other traditional penalties.

- The OSC was given the authority to make rules requiring that reporting issuers (i) appoint audit committees, the composition, qualifications and responsibilities of which are to be prescribed by the OSC, (ii) maintain a system of internal controls, (iii) institute a system of disclosure controls and procedures with respect to disclosure required under Ontario securities law, and (iv) obtain certification from the CEO and CFO with respect to internal and disclosure controls. In addition, the OSC was given the authority to define auditing standards for attesting to and reporting on internal controls. On the basis of this authority, the OSC has published a number of new proposed rules, such as Proposed Multilateral Instrument 51-102-*Continuous Disclosure Obligations*, Proposed Multilateral Instrument 52-108-*Auditor Oversight*, Proposed Multilateral Instrument 52-109-*Certification of Disclosure in Companies' Annual and Interim Filings* and Proposed Multilateral Instrument 52-110-*Audit committees*.

- The OSC was granted the power to initiate reviews of continuous disclosure practices, including the authority to compel production of all documentation related to disclosures under review (with provision for exemption from "freedom of information" disclosure requests where the OSC consents).

Although Bill 198, together with "minor technical changes" is expected to be re-tabled and proclaimed at some point, no firm date has been announced. In addition, it remains to be seen how the new Ontario Liberal government will respond to Bill 198 which was formulated and tabled under the previous Ontario Tory government, although it seems likely that it will be adopted at some point. The remaining proposed amendments, if ultimately adopted, would create new offences for fraud, market manipulation and misleading or untrue statements, and would also introduce a regime of statutory civil liability for secondary market disclosure.

If and when the remainder of Bill 198 comes into force, as well as reporting issuers and their directors and officers, and influential person and their directors and officers, experts (i.e. a "person or company whose profession gives authority to a statement made in a professional capacity by the person or company including, without limitation, an accountant, actuary, appraiser, auditor, engineer, financial analyst, geologist or lawyer") are potentially liable where:

Under the proposed Ontario secondary market liability regime, experts (which include an accountant, actuary, appraiser, auditor, engineer, financial analyst, geologist and lawyer) may be liable for misrepresentations in their reports, statements or opinions.

- a core or non-core document containing a misrepresentation, or
- a public oral statement containing a misrepresentation,

is released or made by the issuer (or a person with actual, implied or apparent authority to release the document or to speak on behalf of the issuer), if each of the following is also true:

- the misrepresentation is also contained in a report, statement or opinion made by the expert;
- the document or public oral statement includes, summarizes or quotes from the report, statement or opinion of the expert; and
- the expert either released the document or made the statement itself or consented in writing to the use of the report, statement or opinion in the document or public oral statement.

While the amendments would create statutory causes of action, they also create a number of defences that experts could rely upon that may preclude liability, or limit damages in certain situations, including:

- due diligence;
- properly qualified forward-looking information;
- plaintiff knew of material change or misrepresentation;
- released without an expert's knowledge;
- corrective action taken;
- reasonable reliance on representations contained in a third party's public filing; and
- withdrawal of consent.

Damages against experts would be limited to the greater of $1 million and the revenue that the experts, and the affiliates of the expert, have earned from the issuer and its affiliates in the past 12 months; however, limits do not apply if the plaintiff proves the expert authorized, permitted or acquiesced in the making of the misrepresentation while knowing that it was a misrepresentation, or influenced the making of the misrepresentation while knowing that it was a misrepresentation.

For a complete synopsis of Bill 198, see "Litigation Unleashed – A Guide to Ontario's Proposed Secondary Market Liability Regime" published by Stikeman Elliott LLP and which can be ordered from www.stikeman.com.