THE VALUATION LAW REVIEW

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Corporate/Securities Decisions and Certain Canadian 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 Ogilvy Renault 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 of Securities Regulator, as applicable.

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I. CANADIAN CASES

page 8

Kerr v. Danier Leather Inc.
[2007] S.C.C. 44
Supreme Court of Canada
October 12, 2007
The disclosure of "material facts" pursuant to the Ontario *Securities Act* is required only up to the date on which a corporation issues a final prospectus. Once the final prospectus is filed and a receipt is obtained, only a "material change" in the business, operations or capital of the business will require the issuer to file an amendment to the prospectus. Such disclosure is a legal obligation and not a matter of business judgment.

page 10

Ford Motor Co. of Canada v. Ontario Municipal Employees Retirement Board
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The Supreme Court of Canada dismissed the application for leave to appeal the decision of the Ontario Court of Appeal without reasons. The Court of Appeal had found that a transfer pricing system that favoured the U.S. parent company was oppressive of minority shareholders of the Canadian subsidiary.

page 10

MBNA Canada Bank v. Markson
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The Supreme Court of Canada dismissed the application for leave to appeal the decision of the Ontario Court of Appeal, without reasons. The Court of Appeal certified the action as a class proceeding even though the question of whether any particular credit cardholder had been charged a criminal rate of interest on cash advances could only be determined on an individual basis.

page 13

Sears Canada Inc. (Re)
(2006), 22 B.L.R. (4th) 267
Ontario Securities Commission
August 8, 2006
The Ontario Securities Commission considered two applications relating to the bid by Sears Holdings Corporation to privatize its subsidiary, Sears Canada Inc. The Commission's decision provides guidance on disclosure requirements, minority shareholder protections and the role of Special Committees in the context of take-over bids.

page 19

In the Matter of Falconbridge Limited
(2006), 29 O.S.C.B. 6783
Ontario Securities Commission
August 17, 2006

In the Matter of Inco Limited and Teck Cominco Limited
Ontario Securities Commission
August 28, 2006
Two 2006 decisions of the Ontario Securities Commission considered shareholder rights plans in the context of contested take-over bids. These decisions confirm that the Commission will lift shareholder rights plans where doing so will promote auctions and shareholder choice.

Page 25

Ventas Inc v. Sunrise Senior Living Real Estate Investment Trust
[2007] O.J. No. 1083
Ontario Court of Appeal
March 23, 2007
Parties to an auction process will be held to the terms of standstill agreements that preclude the consideration of post-auction bids where such agreements were clear and unambiguous and otherwise fair within the overall framework of an auction process designed to maximize shareholder value.

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

page 26

Quebecor Media Inc. v. Osprey Media Income Fund
[2007] O.J. No. 3070
Ontario Superior Court of Justice
July 26, 2007
The board's acceptance of a competing bid after the auction process was not a breach of the standstill agreement or a failure to inquire into the bona fides of a competing bid.

page 27

Aurizon Mines Ltd. v. Northgate Minerals Corp
[2006] B.C.J. No. 1584
British Columbia Court of Appeal
July 14, 2006
The court will enforce the terms of confidentiality and standstill agreements even if doing so precludes shareholders from considering or tendering to a hostile takeover bid. The court will not permit a party to benefit from its own breach of such a contract.

page 29

Sterling Centrecorp Inc. (Re)
[2007] O.J. No. 3072
Ontario Superior Court of Justice
July 26, 2007
The court approved a plan of arrangement, noting that directors' obligations to maximize shareholder value does not mean simply being responsive to the possibility of a higher price without any assessment of the risk associated with the higher offer.

page 33

Scion Capital, LLC v. Gold Fields Ltd.
[2006] O.J. No. 466
Ontario Superior Court of Justice
February 6, 2006

Scion Capital, LLC v. Gold Fields Ltd.
[2006] Y.J. No. 17
Yukon Territory Supreme Court
February 24, 2006
These cases discuss claims and remedies related to insider trading and the approval of plans of arrangement. Courts will be reluctant to interfere with the properly exercised decisions of a majority of securityholders. Disgruntled minority shareholders may be better off invoking dissent rights rather than directly attacking a resolution that passes with a super-majority.

page 37

Bingham v. Ashton Mining of Canada Inc.
[2007] B.C.J. No. 410
British Columbia Superior Court
March 1, 2007
The court considers equivalent values in going-private deals. Lock-up agreements with major shareholders will not necessarily disadvantage minority shareholders such that a pure majority of the minority vote is required.

page 41

Ashton Mining of Canada Inc. v. Kwantes
[2007] B.C.J. No. 2010
British Columbia Superior Court
September 14, 2007
Following the amalgamation of Ashton Mining of Canada, certain shareholders sought to enforce their dissent and appraisal rights.

page 43

Silber v. DDJ Canadian High Yield Fund
[2006] O.J. No. 2503
Ontario Superior Court of Justice
June 19, 2006
Corporate law dissent and appraisal rights are not available to those who hold units in a closed-end investment fund.

page 45

Manitoba (Securities Commission) v. Crocus Investment Fund
[2007] M.J. No. 87, affirmed [2006] M.J. No. 30 (MCQB)
Manitoba Court of Appeal
March 30, 2007
A Manitoba corporation which is not insolvent, but is under the control of a receiver, may advance funds to pay for ongoing legal defense costs incurred by its former directors and officers prior to the conclusion of those legal matters, and may do so even when it and those former directors and officers are the subject of regulatory proceedings and shareholder class action litigation, subject to certain rights of reimbursement.

page 47

Le Maitre Ltd. v. Segeren et al.
[2007] O.J. No. 2047
Ontario Superior Court of Justice
May 24, 2007
The court can apply the principles for granting interlocutory injunctive relief in oppression proceedings, although the court retains discretion to administer this remedy to obtain a fair result.

II. U.S. CASES

page 50

Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit
547 U.S. 71 (2006)
Supreme Court of the United States
March 21, 2006
The *Securities Litigation Uniform Standards Act* of 1998 bars claims by securityholders under state law – and not just claims by purchasers and sellers – and such interpretation was consistent with its §10(b) (Securities Exchange Act of 1934) and SEC Rule 10b-5 jurisprudence.

page 52

Tellabs, Inc. v. Makor Issues & Rights, Ltd.
Supreme Court of the United States
June 21, 2007
The *Private Securities Litigation Reform Act*, 1995 requires plaintiffs to state with particularity facts showing a state of mind on the part of the defendants to deceive. A plaintiff will have pleaded facts with sufficient particularity if the inference of a defendant's mental state is at least as strong as any other plausible inference.

page 54

Louisiana Municipal Police Employees' Retirement System v. Edwin M. Crawford
2007), C.A. No. 2635-N
Court of Chancery, State of Delaware
February 23, 2007
The Delaware Court of Chancery issued a preliminary injunction postponing for at least 20 days a vote of the stockholders of Caremark RX, Inc. on its proposed merger with CVS Corporation. The Court's reasoning is notable because it emphasizes the importance of looking at the larger circumstances in determining whether sufficient disclosure has been made.

page 57

In Re Netsmart Technologies, Inc. Shareholders Litigation
(2007) C.A. No. 2563-VCS
Court of Chancery, State of Delaware
March 14, 2007
The court granted a preliminary injunction and delayed the shareholder vote on a merger until after the corporation's board disclosed to shareholders more complete information about why it ruled out a transaction with strategic buyers and the valuation of its future expected cash flows. The court declined to enjoin the vote until after the company conducted a search for strategic buyers.

page 60

In Re The Topps Company Shareholders Litigation
(2007) Cons. C.A. No. 2786-VCS
Court of Chancery, State of Delaware
June 14, 2007
The misuse of a standstill agreement to prevent stockholders from obtaining material information related to a potentially superior bid runs contrary to the board's *Revlon* duties. The failure by the board to fully disclose assurances given by a bidder of its intention to retain key personnel or to disclose the existence of an unfavourable valuation presentation could be grounds to enjoin a shareholder vote until such disclosure is made.

page 66

In Re Lear Corporation Shareholder Litigation
(2007) Cons. C.A. No. 2728-VCS
Court of Chancery, State of Delaware
June 15, 2007
The Chancery Court addressed: (1) disclosure of material facts relating to the target's CEO, who had potential personal economic motivations behind a proposed acquisition by a private equity fund, and (2) the fiduciary obligations of a board of directors to act reasonably to obtain the highest price available.

page 71

United Rentals, Inc. v. RAM Holdings Inc.
(2007), C.A. No. 3360-CC
Court of Chancery, State of Delaware
December 21, 2007
United Rentals, Inc. lost a bid to force a $4-billion takeover by Cerberus Capital Management LP when a judge ruled that the merger agreement allowed the buyer to pull its offer.

Certain Regulatory Developments (Summary)

III. Certain Canadian Regulatory Developments

Page 75

Harmonized Take-over and Issuer Bid Regime

The Canadian Securities Administrators ("CSA") are implementing new rules on take-over and issuer bids which harmonize the treatment of bids in all jurisdictions of Canada. All Canadian jurisdictions, other than Ontario, have or will shortly adopt Multilateral Instrument 62-104 *Take-over Bids and Issuer Bids*. In Ontario the corresponding regime was implemented by the amendment of Part XX of the *Securities Act* (Ontario) and the adoption of Ontario Securities Commission Rule 62-504 *Take-over Bids and Issuer Bids* on February 1, 2008. As a result of these initiatives, a common set of rules and policies will soon be in effect across Canada.

Page 76

New Rule on Related Party Transactions Introduced in Ontario and Quebec

The Quebec and Ontario securities regulators have introduced Multilateral Instrument 61-101 *Protection of Minority Securityholders in Special Transactions*. The new Instrument harmonizes the prior Ontario and Quebec rules applicable to related party transactions.

Page 77

New Rules on Forward-Looking Information

Effective December 31, 2007 the CSA has new requirements applicable to the disclosure and updating of forward-looking information by issuers. The new regime which applies to all forward-looking information released by an issuer, is intended to improve the quality and consistency of forward-looking information in the marketplace.

Page 80

Proposed New Rules on Executive Compensation

On February 22, 2008 the CSA published for public comment draft executive compensation disclosure rules which, following the recent U.S. initiative, address the quality of such disclosure. The purpose of the proposed rules is to ensure investors receive comprehensive information about the value of all forms of compensation to which the executive officers of an issuer receive or may receive in a particular year. The proposed effective date of these proposed rules is December 31, 2008.

Page 81

Proposed New Rules on Internal Controls Certification

The CSA have published for public comment a new national instrument which, if enacted, would repeal and replace Multilateral Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*. The proposed rules will require issuers to adopt a control framework in the design of their internal controls over financial reporting and the CEO and CFO to certify that they have evaluated the effectiveness of the issuer's ICFR. The proposed rules, if enacted, will take effect for financial periods ending on or after December 15, 2008.

Page 82

Legislated Initiatives in Quebec and Other Jurisdictions Creating Statutory Secondary Market Liability

Following the introduction of statutory liability for secondary market liability in Ontario in late 2005, Quebec has recently enacted similar legislation. Like the existing Ontario legislative provisions, the new legislation will give investors who acquire securities in the secondary markets rights against issuers, directors, officers, experts and certain other persons connected with an issuer for written and oral misrepresentations and for failure to make timely disclosure of material changes. Currently all provinces in Canada have legislation in effect which provides for secondary market liability other than British Columbia. British Columbia has introduced such legislation but it is not yet proclaimed in force.

Page 84

Business Corporations Act (Ontario) is Amended

Amendments to modernize the *Business Corporations Act* (Ontario) to bring it into line with the *Canada Business Corporations Act* took effect August 1, 2007. The amendments, among other things, reduce the Canadian director residency requirements and extend the indemnification provisions of the legislation applicable to directors and officers of Ontario corporations.

Page 85

Proposed TSX Amendments Regarding Share Exchange Acquisitions

In October 2007, the Toronto Stock Exchange (the "TSX") published for public comment a notice as to whether it should introduce amendments to its rules which will require securityholder approval on acquisitions of public companies by TSX-listed acquirors. The TSX is considering requiring this approval where the securities of the TSX-listed acquiror being issued as consideration for the purchase exceed 25% (or possibly some higher or lower percentage) of the listed acquiror's outstanding securities. The current rules do not require approval by securityholders of the TSX-listed acquiror where the target company is a reporting issuer with 50 or more securityholders (exclusive of insiders and employees).

IV. Certain U.S. Regulatory Developments

Page 86

SEC Approves New NASD Rule on Fairness Opinions

Effective December 8, 2007, the U.S. Securities and Exchange Commission approved the National Association of Securities Dealers Rule 2290 requiring members of the National Association of Dealers to disclose material conflicts of interest in rendering fairness opinions in change of control transactions.

Summary of Caselaw, Legislative and Regulatory Developments 2006-2007

Canadian courts and regulators considered a range of corporate finance matters between April 2006 and December 2007 (regulatory to May 23, 2008), and have opined on subjects ranging from the use of swap transactions to "park" securities in a takeover context, to the availability of corporate law remedies for investors in closed-end investment funds.

Disclosure remains a key concern of the courts and regulators. Courts and regulators will intervene in takeover bids or proxy contests if there has been inadequate disclosure to allow shareholders to adequately exercise their rights. Although several cases have reaffirmed that the business judgment rule will shield certain business decisions made in good faith from judicial scrutiny, the Supreme Court of Canada has unequivocally stated that the exercise of business judgment will not trump legal obligations including statutorily mandated disclosure.

In several circumstances, the courts and regulators have made statements which suggest that maximizing shareholder value within an auction or bid process is not an end in itself. In determining whether a plan of arrangement, auction or bid process is fair, the courts and regulators have considered whether the Board of Directors or the Special Committee had fulfilled their fiduciary duties, particularly when establishing the framework for any auction. Courts and regulators also considered risk factors inherent in bid proposals and whether a party's conduct was abusive in light of the established auction or bid process. For example, the terms of lock-up agreements and the use of swaps to "park" securities have been considered in determining if these mechanisms were abusive within the circumstances. Courts and regulators have shown a willingness to intervene where an auction process or conduct is unfair.

Courts will also consider the fairness of the auction or bid process in cases impugning standstill or similar agreements. If the overall auction

process is fair, courts have shown that they will hold sophisticated parties to the terms of their agreements.

Regulators will lift shareholder rights plans if doing so will promote auctions and shareholder choice, but will allow such plans to continue for a limited amount of time to allow directors to exercise their fiduciary duties in appropriate circumstances.

Class action jurisprudence also continues to evolve. Recent cases suggest that plaintiffs may find it easier to obtain certification of class proceedings where aggregate damages are sought, as the legality of the impugned conduct can be determined without consideration of the individual circumstances of each member of the class.

The United States Supreme Court has clarified certain forum and pleading standards for class action securities litigation, which may have an overall dampening effect on such litigation. It is now confirmed that the *Securities Litigation Uniform Standard Act of 1998* bars claims by securityholders under state law and that federal law is the only appropriate vehicle for asserting class action securities fraud claims. Additionally, the Supreme Court has considered the *Private Securities Litigation Reform Act 1995* requirements for the pleading of scienter required by Rule 10b-5 claims, and has found that plaintiffs must plead a mental state of scienter at least as strong as any other interference.

The Delaware Chancery Court was asked to intervene in a number of take-over battles or other contested business combinations. Like its Canadian counterparts, the Delaware court considered whether adequate disclosure had been made to shareholders about potential business combinations to permit these to properly exercise their appraisal or other remedies. While deferring to the business judgment of officers and directors in certain circumstances, shareholder votes were temporarily enjoined to permit disclosure of matters such as executive compensation, valuation methodologies and competing bids from bidders constrained by terms of standstill or other agreements. Disclosure will be ordered where a failure to disclose information could be coercive or unfair to shareholders. Furthermore, unless agreements between corporate entities are abusive of shareholders or each other, the parties to them will be held to their terms. Parties should therefore carefully scrutinize the wording of all their agreements to ensure that they spell out the intended consequences.

Regulatory Developments (April 2006 to May 23, 2008)

Canadian Securities Administrators have introduced new rules to harmonize the treatment of issuer and takeover bids and provide a common set of rules across Canada. They have also introduced new rules regarding disclosure of forward-looking information and have proposed new rules regarding executive compensation disclosure and internal controls certification. There is now a legislative framework enacted in all provinces except British Columbia that provides for statutory secondary market liability. British Columbia has introduced similar legislation but it has not yet been proclaimed into force.

In the United States, the Securities and Exchange Commission approved a rule which will require members of the National Association of Securities Dealers to disclose material conflicts of interest in rendering fairness opinions in change of control transactions.

Certain Caselaw Developments

I. Canadian Cases

Kerr v. Danier Leather Inc.
[2007] S.C.C. 44
Supreme Court of Canada
October 12, 2007

The Supreme Court of Canada upheld the Ontario Court of Appeal decision, which itself had overturned the decision of the trial court (reported in April 2006, Volume 12, Issue 2 of the VLR).

The decision confirms that disclosure of "material facts" pursuant to the *Ontario Securities Act* (the "*Act*") is required only up to the date on which a corporation issues a final prospectus. Once the final prospectus is filed and a receipt is obtained, only a "material change" in the business, operations or capital of the business will require the issuer to file an amendment to the prospectus. This decision also confirms that such disclosure is a legal obligation and not a matter of business judgment.

Facts

As Danier Leather prepared for its initial public offering, it submitted, in its final prospectus, the company's results for the first three quarters of its 1998 financial year as well as an earnings forecast for the company's fourth quarter. However, during the period between the submission of the final prospectus and the closing of the offering, management learned from an internal financial analysis that unusually hot weather would seriously affect the results forecasted in the prospectus for the last quarter. Danier did not release that information in a material change report until two weeks after the offering. After that material change report was filed, the stock, which was trading at $11.25, plummeted to $8.25. Later in the quarter, a combination of cooler weather and a successful

sales campaign resulted in sales that substantially achieved the original earnings forecast. A number of purchasers who had sold their shares soon after the material change report was filed initiated a class action against the respondents for failure to disclose the intra-quarterly results in connection with its offering memorandum.

The trial judge found the defendants in breach of the *Act*, concluding that Danier's failure to disclose the known change in forecast constituted a misrepresentation under section 130 of the *Act*, despite also recognizing that s. 57(1) of the Act provides for the disclosure of post-filing material changes but not post-filing material facts. The trial judge decided that the original forecast ceased to be objectively reasonable as of the closing date. Without requiring that individual shareholders demonstrate actual loss due to the misrepresentation, the trial judge awarded damages in the amount of $2.35 per share. The damage was calculated based on the difference between the prospectus share price and the price of shares after the market had absorbed the misrepresentation.

The Ontario Court of Appeal reversed the trial decision. It held that the general provision of s. 130(1) of the Act could not be used to override the specific provision of s. 57(1). In addition, it held that the trial judge had erred in finding that the original forecast contained an implied representation of objective reasonableness. Finally, the Court of Appeal concluded that the trial judge failed to assess Danier's management actions in light of the business judgment rule.

The Decision of Supreme Court of Canada

The Supreme Court of Canada held that it would be contrary to the scheme of the *Act* to find civil liability against an issuer for failing to disclose post-filing information that does not amount to a material change, if that issuer had fully complied with its regulatory obligations under s. 57(1) of the *Act*.

The appellants had argued that the intra-quarterly result was a material change that should have been disclosed under s. 57(1), not just a material fact as the trial judge had found. The Supreme Court held that the trial judge had correctly found that a change in results is not a "change in the business, operations or capital of the issuer" and therefore is not a "material change". Although poor intra-quarterly results may *reflect* a material change in business operations or may motivate a company to

effectuate a material change in its business, operations or capital, it does not, in itself, constitute a material change.

The Supreme Court also partially restored the trial judge's finding that the original forecast contained an implied representation of objective reasonableness based on the specific language in the prospectus. However, this implied representation extended only until the prospectus was receipted and did not extend beyond and until closing. The Court noted that the prospectus did not promise that the forecast would be updated if an as soon as conditions changed.

The Supreme Court held that disclosure requirements under the Act were a matter of legal obligation and can not be "subordinated to the exercise of business judgment". The business judgement rule provides that "managers should be free to take reasonable risks without having to worry that their business choices will later be second-guessed by judges" and has as its rationale management's relative expertise in maximizing returns for shareholders. However, the business judgment rule has no application to disclosure decisions which are legally mandated, and "should not be used to qualify or undermine the duty of disclosure."

Ford Motor Co. of Canada v. Ontario Municipal Employees Retirement Board
[2006] S.C.C.A. No. 77
Supreme Court of Canada
August 24, 2006

The Supreme Court of Canada dismissed the application for leave to appeal the decision of the Ontario Court of Appeal without reasons. The Court of Appeal had found that a transfer pricing system that favoured the U.S. parent company was oppressive of minority shareholders of the Canadian subsidiary. The Court of Appeal decision was reported in the April 2006, Volume 12, Issue 2 of the VLR.

MBNA Canada Bank v. Markson
[2007] S.C.C.A. No. 346
Supreme Court of Canada
November 15, 2007

The Supreme Court of Canada dismissed the application for leave to appeal the decision of the Ontario Court of Appeal, without reasons. The

Court of Appeal had overturned the lower court decisions, and granted an order for the certification of this action as a class proceeding. The claim alleged that certain credit card fees and interest charges amounted to a criminal rate of interest. The Court of Appeal certified the action as a class proceeding even though the question of whether any particular cardholder had been charged a criminal rate of interest could only be determined on an individual basis. *Markson* is an important decision in that it appears to represent a new development in the interpretation and application of the provisions in ss. 23 and 24 the *Class Proceedings Act* (the "CPA") that provide for an aggregate assessment of damages to the class as a whole.

Background

Under the CPA, an action cannot proceed to trial as a class action until it has been certified as such by the court. The test for certification contains several components, but a key factor is whether a class action is the preferable procedure: *i.e.* does it make sense to deal with all or some of the class members' claims in a single proceeding. This analysis often focuses on whether it is necessary to look at each class member's particular circumstances in order to determine if the defendant is liable to any specific class member.

The *Markson* Case

The plaintiff brought a class action against MBNA on behalf of cardholders based on the allegation that certain transaction fees and interest charges on certain cash advances resulted in a criminal rate of interest. However, the alleged criminal rate of interest would only arise if the individual cardholder engaged in a fairly specific and unusual combination of borrowing and repayment practices. Indeed, it appears that the proposed representative plaintiff himself engaged in unusual borrowing and repayment practices for the sole purpose of being charged a criminal rate of interest so that he could bring this litigation. The evidence was that the vast majority of cardholders would never have been charged a criminal interest rate and thus would not have suffered any loss. Further, for the handful of cardholders that had suffered a loss, the maximum damages that could have been suffered on any particular cash advance was $7.50.

Based on the above evidence, the motion judge had refused to certify the action and further held that the class action would be unmanageable

because the bank would have to review roughly 8 million transaction in order to determine if any class member had actually suffered a loss. Individual issues would dominate common issues. Further, the cost of determining liability would far outstrip any potential recovery. The decision of the motion judge was upheld by the Divisional Court.

At the Court of Appeal, the plaintiff argued that individual examinations were not necessary because ss. 23 and 24 of the CPA allowed for the aggregate assessment and apportionment of damages. Relying on these sections, the plaintiff argued that if the class action was certified, he could simply establish at trial what the total damages were for the class and then (using statistical evidence and random sampling, if necessary) determine how the damages should be distributed to the class members. The bank argued that these sections, pursuant to their express terms, could only be used once liability had been established. Before the court could calculate damages, the plaintiff had to prove that individual class members had suffered a loss, which required a review of individual transactions. Essentially, the bank argued that the plaintiff could not use ss. 23 and 24 to avoid the requirement of having to establish liability. The Court of Appeal disagreed.

The Court of Appeal held that a plaintiff only has to prove ‘potential liability’ to rely on ss. 23 and 24. In the present case, the plaintiff only has to show at trial that the bank’s practices had the potential to cause an illegal interest rate being charged to some class members. Once such potential liability was established, the court could employ “statistical sampling” (as provided for in s. 23) to determine the aggregate amount of the bank’s global liability to the class. Under s. 24, the court could then allocate or distribute such aggregate damages to class members on an “average or proportional basis” if it would be “impractical or inefficient” to allocate damages based on actual individual loss. Because all of this can be achieved without having to review cardholders’ individual transaction histories, none of the problems identified by the lower courts would arise.

The implication of the Court of Appeal’s analysis is that class members who were never charged a criminal rate of interest could be entitled to a share of an award. The Court of Appeal stated that this is “exactly the result contemplated by s. 24”.

Consequences of the Markson Decision

Prior to *Markson*, ss. 23 and 24 of the CPA had received little judicial scrutiny but judges appeared to conclude that these sections could be applied only after liability had been established. Most had interpreted the case law to require proof of actual liability, including proof that class members who were to share in any proposed aggregate judgment or award had suffered an actual loss. The Court of Appeal's decision that a plaintiff need only demonstrate potential liability before having recourse to ss. 23 and 24 might signal significant expansion of the scope of these provisions.

Sears Canada Inc. (Re)
(2006), 22 B.L.R. (4th) 267
Ontario Securities Commission
August 8, 2006

The Ontario Securities Commission considered two applications relating to the bid by Sears Holdings Corporation ("Sears Holdings") to privatize its subsidiary, Sears Canada Inc. ("Sears Canada"). The Commission's decision, which was upheld by Ontario's Divisional Court, provides significant guidance on disclosure requirements, minority shareholder protections and the role of Special Committees in the context of take-over bids.

Facts

In December 2005, Sears Holdings announced its intention to acquire all outstanding shares of Sears Canada at a price of $16.86 per share. In order to take Sears Canada private, the bid contemplated a subsequent acquisition transaction ("SAT") and contained a condition that a majority of the minority tender into the bid. Under securities rules, the SAT would require the approval of the majority of the minority shareholders; however, shares tendered into the initial offer could be included in the vote. Sears Holdings also disclosed that it had entered into a lock-up agreement with a shareholder that owned 9.06% of the outstanding shares.

Following the announcement, Sears Canada formed a Special Committee to evaluate the bid. The financial advisor retained by the Special Committee determined that the fair market value of the shares of Sears Canada was in the range of $19.00-$22.25 and that Sears Holdings offer was inadequate. The Special Committee unanimously recommended that

Sears Canada shareholders reject the offer. Following the delivery of the valuation, Sears Holdings commenced its offer which did not contain the minimum tender condition.

The bid, originally set to expire on March 17, 2006, was extended to March 31. On March 28, Sears Holdings entered into support agreements with the Bank of Nova Scotia ("BNS") and Scotia Capital Inc. ("Scotia Capital") under which these agreed to vote their shares in favour of the SAT. The agreements were held in escrow while Sears Holdings negotiated a deposit agreement with Vornado Realty Trust ("Vornado") and a support agreement with the Royal Bank of Canada ("RBC").

The deposit agreement reached with Vornado provided that it would deposit its shares for a revised price of $18.00 per share, an extended expiry date, price protection and a litigation release. On April 4, Sears Holdings extended the bid for all other shareholders at the revised price of $18.00; however it did not disclose the price protection and litigation release given to Vornado.

On April 6, after the support agreement with RBC was signed, Sears Holdings announced that unnamed shareholders had agreed to vote in favour of the SAT, giving Sears the required majority of the minority support. Sears Holdings also announced a revised bid structure, under which the offer would be extended until August 31, while the SAT was expected to close in December 2006. This structure eliminated the need to obtain a new independent valuation prior to the SAT and allowed shares tendered under the insider bid to be counted when the required majority of the minority approval was sought. Further, the December 2006 close date provided the banks with large tax savings, which they would not have realized had the SAT closed earlier. The banks would not support the SAT without the later closing date.

Subsequently, three minority shareholders, Pershing Square Capital Management L.P. ("Pershing"), Hawkeye Capital Management, LLC ("Hawkeye") and Knott Partners Management LLC ("Knott"), formed a group to oppose the takeover (collectively known as the "Pershing Group"). The Pershing Group and Sears Holdings filed separate applications with the Commission alleging that each other had breached the *Act* in relation to the takeover bid.

The Sears Holdings Application

Sears Holdings claimed that the Pershing Group, and Pershing specifically: failed to comply with the early warning disclosure requirements regarding their shareholdings; engaged in abusive minority tactics to frustrate the bid; and engaged in conduct that resulted in an artificial price for Sears Canada shares. The Commission dismissed Sears Holdings' application in its entirety.

Swap Agreements and Disclosure Requirements

The Commission made significant findings regarding the use of swap transactions. Sears Holdings argued that Pershing avoided early disclosure obligations through swap arrangements, whereby it disposed of beneficial ownership of shares while maintaining control over the voting rights. Pershing argued it did not continue to exercise control over the shares forming part of the swap and the swaps were not made to avoid disclosure requirements.

Although it dismissed the allegation regarding Pershing's swaps in this case, the Commission noted that there may be circumstances where the use of swaps to "park" securities in a take-over context for the purpose of affecting an outstanding offer would constitute abusive conduct contrary to the public interest.

The Pershing Group Application

The Pershing Group alleged that Sears Holdings failed to disclose material information including the release in the Vornado agreement and the full tax consequences of the revised offer and SAT. It also alleged that Sears Holdings provided the banks and Vornado consideration of greater value than that offered to the other minority shareholders. The Pershing Group also claimed, considering all of the circumstances, that the bid was coercive and abusive of minority shareholders and contrary to the public interest. The Commission agreed that Sears Holdings had failed to make material disclosures and that its conduct was abusive.

The Effect of Firewalls

The Pershing Group claimed that Scotia Capital and BNS were “joint actors” with Sears Holdings and that, as such, their votes should be excluded from the minority calculations for the purposes of determining shareholder approval of the SAT. The Pershing Group noted that Scotia Capital and BNS had, respectively, financial advisor and lending relationships with Sears Holdings. Scotia Capital and BNS argued that the sub-units that acquired Sears Canada shares were effectively “walled off” from each other and from the sub-unit that provided financial advice to the bidder.

In rejecting Pershing’s claim, the Commission recognized that the creation of firewalls between and within Canadian banks and their investment banking subsidiaries is a well-established practice. As the role of Scotia Capital did not extend beyond providing customary advisory and administrative functions to Sears Holdings, these parties could not be considered joint actors.

Disclosure Obligations

The Pershing Group also claimed that Sears Holdings failed to disclose or failed to disclose on a timely basis facts and information that minority shareholders would consider to be material. The Commission agreed and found that the identities of the shareholders who made deals with Sears Holdings to support the SAT were material and should have been disclosed. The litigation release given to Vornado in the deposit agreement also ought to have been disclosed. Sears Holdings should also have disclosed the BNS and Scotia Capital agreements sooner, even though they were held in escrow until the other agreements were signed.

Collateral Benefits

Section 97 of the *Act* provides that where a bid is made, all of the holders of the same class of securities must be offered identical consideration. Subsection 97(2) specifically prohibits a bidder from entering into any collateral agreement or understanding with a shareholder that has the effect of providing the shareholder with consideration of greater value than that offered to other shareholders. The Pershing Group argued that the litigation release given in the Vornado agreement and the later closing dates provided in the support agreements with the banks provided these shareholders with consideration of greater value than that offered to other shareholders.

The Commission agreed that the release given to Vornado was a collateral benefit. It did not matter that Sears Holdings did not attach value to the release as Vornado had attached great importance to the provision of the release. Thus, on its face, the granting of the release violated subsection 97(2) of the *Act*.

The Commission also agreed with the Pershing Group that the tax benefits received by the banks could be treated as collateral benefits. The circumstances of the banks purchasing their shares were such that income tax stop loss rules would have been triggered had the SAT completed prior to December 14, 2006. (These rules provide that tax losses cannot be deducted where tax-free dividends have been received and the shares have been held for less than 365 days from the date of purchase; the tax impact arose for the banks because of a payment of an extraordinary dividend to all Sears Canada shareholders in December 14, 2005.) As a result, Sears Holdings knew that the banks would not want to tender their shares prior to December 14, 2006. The support agreements with the banks included terms stating that the SAT would be completed in mid-December. This timing would afford the banks millions of dollars in tax benefits.

The Commission noted that it is normal for bidders to consider the tax planning objectives of shareholders when structuring their bids, and that the *Act* does not require that all holders of the same class of securities be offered identical after-tax consideration. However, in this instance, Sears Holdings accommodated the tax planning objectives of select shareholders in preference to others after the bid had commenced. As such, the support agreements gave the banks consideration of greater value than that offered to the other shareholders.

Abusive Conduct

In considering whether the bid was abusive, the Commission focussed on the treatment of the Special Committee by Sears Holdings. The Commission found that Sears Holdings had failed to make proper and timely disclosure to the Special Committee, which prevented the Special Committee from properly assessing the Sears Holdings bid. Further, Sears Holdings made public comments attacking members of the Special Committee and sought the early resignation of the independent directors. It also attacked the integrity of the independent valuation.

The Commission stated that these actions taken by Sears Holdings were very troubling. Insiders who wish to make an insider bid have an obligation to cooperate with the Special Committee as its discharges its statutorily mandated role. The bidder should disclose to the Special Committee all material information such as the nature of support agreements reached with key shareholders so that it can make a proper assessment of the bid.

The Commission's Order and its Public Interest Jurisdiction

While the Commission was not convinced that the take-over bid was as a whole so abusive to warrant a cease trade order, it invoked the collateral benefit provisions under subsection 97(2) of the *Act* to prevent the shares which were subject to the support agreements and the deposit agreement from voting on the SAT, so that decision would be determined by minority shareholders uninfluenced by shares or votes secured by conferring collateral benefits or preferential treatment.

The Commission noted that had it not found a violation of the prohibition of collateral benefits, it could make an order under its public interest power to prohibit trading in the shares attached to the support agreements and the deposit agreements from being voted. Although it was unnecessary to do so, the Commission also noted that elements of the conduct of Sears Holdings in pursuing its offer were coercive and abusive of the minority shareholders of Sears Canada and the capital markets generally.

Appeal to the Divisional Court

Sears Holdings appealed the Commission's Order to the Divisional Court. Applying a standard of reasonableness in reviewing the Commission decision, the court upheld the Order. The court stated that while it may not necessarily agree that the release provided in the Vornado agreement was a collateral benefit, the determinations of the Commission were reasonable. The court also agreed that Sears' Holdings tactics were abusive of the minority shareholders.

In the Matter of Falconbridge Limited
(2006), 29 O.S.C.B. 6783
Ontario Securities Commission
August 17, 2006

In the Matter of Inco Limited and Teck Cominco Limited
Ontario Securities Commission
August 28, 2006

Two 2006 decisions of the Ontario Securities Commission considered shareholder rights plans in the context of contested take-over bids. These decisions confirm that the Commission will exercise its public interest power to lift shareholder rights plans where doing so will promote auctions and shareholder choice. However, the Commission will permit rights plans to continue where there is a real and substantial risk that shareholders will be subjected to an unfair or coercive bid unless the plan remains in place.

Falconbridge (Re)

Two competing bidders were vying to take over Falconbridge Ltd. ("Falconbridge"): Inco Limited ("Inco"), with its friendly bid, and Xstrata plc ("Xstrata"), which had made an unsolicited offer. During the auction, Falconbridge had enacted two sequential shareholder rights plans, both of which would be triggered by the Xstrata bid but not the Inco bid. Xstrata applied to the Commission for an order under section 127 of the *Act* for a cease trade order in respect of securities issued under or in connection with the shareholder rights plan. Falconbridge opposed the application, arguing that the Xstrata bid was coercive and unfair to Falconbridge shareholders, who required the rights plan for protection. The Commission determined that the shareholder rights plan should remain in force for a brief period to reduce the risk the risk to Falconbridge shareholders that the auction would be ended prematurely; however, after that brief period, the plan would be lifted with respect to all bidders.

Facts

Falconbridge resulted from June 2005 amalgamation of the 'old' Falconbridge and its parent company, Noranda Inc. Brascan Corporation ("Brascan"), Noranda's largest shareholder, sold its interest in this 'new' Falconbridge to Xstrata in August of that year for $28 per share. Following the sale and additional share issuances, Xstrata held a 19.08%

interest in Falconbridge. As a condition of its deal with Brascan, Xstrata was required to top-up the purchase price paid to Brascan should it, or any of its affiliates, announce an intention to acquire a majority of the Falconbridge shares at a price higher than $28 per share. Following the share purchase, Xstrata entered into merger discussions with the Falconbridge Board of Directors ("Falconbridge Board") which were discontinued in September 2005.

Concerned that Xstrata might try to buy only enough shares to attain a blocking position or conduct a partial bid, a move which could deter other potential bidders, the Falconbridge Board adopted a shareholder rights plan ("First Rights Plan") on September 22, 2005. The First Rights Plan allowed existing shareholders, other than a bidder, to purchase further shares at half the market price when a party, acting alone or with related parties, acquired or announced its intention to acquire more than 20% of the Falconbridge shares unless the acquisition was a 'permitted bid'. The First Rights Plan required shareholder approval within six months of its adoption, failing which it would terminate.

The Falconbridge Board was, during this period, also pursuing a bid from Inco. On October 7, 2005, Inco made a formal offer for all the Falconbridge shares for a combination of cash and Inco stock (the "Inco Offer"). The Inco Offer was subject to several conditions, including obtaining regulatory approvals, but the Falconbridge Board of Directors determined it met all the criteria of a 'permitted bid' under the First Rights Plan. Inco and Falconbridge entered into a support agreement on October 10, 2005 that provided that Falconbridge would not solicit or facilitate other offers to acquire Falconbridge and would not terminate the First Rights Plan without Inco's prior written consent. The Inco Offer was extended three times to give Inco more time to obtain the required regulatory approvals.

By March 2006, the Falconbridge Board had not sought shareholder approval of the First Rights Plan. Facing the expiration of the plan, the Falconbridge Board approved a Replacements Rights Plan which was substantially similar to the First Rights Plan.

By mid-May, Xstrata's obligation to top-up the share purchase from Brascan expired and Xstrata made a formal all-cash offer to acquire all the Falconbridge Shares that it did not already own (the "Xstrata Offer"). As

the Xstrata Offer did not contain an irrevocable condition that a majority of the Falconbridge shares, other than those held by Xstrata, be tendered into the bid, it was not considered a 'permitted bid'. The Xstrata Offer was also contingent on the Replacement Rights Plan being waived at the time of take-up and payment.

On May 18, 2006, Xstrata made its application to the Commission. Two days before the hearing, Inco announced an improved offer made jointly with Phelps Dodge Corporation ("Phelps Dodge").

The Commission's Analysis

The Commission reviewed the objectives of the take-over bid provisions in the *Act* as stated in National Policy 62-202. To determine whether to order a cease trade of a rights plan, the Commission must balance the rights of shareholders to tender their shares to the bidder of choice against the duties of the target board to maximize shareholder value. There is no specific test to be applied to all circumstances where the Commission is called to rule upon a bid, and the Commission must exercise its powers in relation to the unique circumstances of each case.

In deciding that the Replacement Rights Plan should remain in force, the Commission applied the test developed in *Re Royal Host Real Estate Investment Trust* which involves looking at several factors, including: shareholder approval or support of the rights plan; the length of time since the bid was announced and made; when the plan was adopted; other defensive tactics implemented by the target company; and the nature of the bid.

Shareholder Support

The Commission noted that neither the First Rights Plan nor the Replacement rights Plan had been put to the Falconbridge Shareholders for approval. The Falconbridge Board stated it had concerns that Xstrata could have used its 19.8% ownership to defeat the Rights Plan at a shareholders meeting even if this were otherwise in the best interest of the remaining Falconbridge shareholders. The Commission held that while shareholder approval alone is not determinative, it can be a seen as a component of shareholder support for the continuation of the plan. The absence of shareholder approval in this case made it difficult to determine the level of shareholder support in such a widely held company.

Timing of the Bids
The Commission noted that the Xstrata Offer was open for 50 days, which was longer than the statutory minimum of 35 days. Falconbridge had argued that the Replacement Rights Plan should remain in place until the Falconbridge shareholders could properly consider the Inco Offer and the Xstrata Offer. The Commission agreed, but stated that this conclusion does not imply a requirement "for the equalization of timing" between friendly and unsolicited bids as a basis for keeping a rights plan in place.

Support Agreement with Inco
The Commission noted that the unusual terms of the Support Agreement with Inco, including those that required Inco's consent prior to waiving the Replacement Plan for competing bids, could discourage competing bids and "severely limit the ability of the shareholders to benefit from a competing bid."

However, the involvement of Phelps Dodge two days before the hearing and the fact that the market price of Falconbridge shares was higher than both the Xstrata and Inco Offers "suggested that the market continued to believe the auction was not over" despite the Support Agreement. These comments may imply that constraining support agreements may only be tolerated by the Commission if there is active bidding or an ongoing auction.

Nature of Xstrata's Bid
Falconbridge argued that Xstrata's bid was coercive as its majority of the minority tender condition was revocable, allowing Xstrata to purchase just enough shares to block the Inco bid and end the auction. Xstrata submitted that the reservation to waive the minimum tender condition was consistent with the industry practice of unsolicited bids and that the reservation was needed as unsolicited bids are exposed to the additional risk that the target company will resist the bid.

The Commission noted that in prior case law offers were found to be coercive if the bidder did not provide any assurance that it will bid for the remaining shares in a second step transaction. Given Xstrata's existing shareholdings in Falconbridge, there was a real possibility that Xstrata would entrench itself by acquiring any tendered shares and then abandoning its offer. The Commission stated that such action could have

a detrimental impact on the auction process and would be contrary to the public interest.

The Commission concluded that it would be in the public interest for the Replacement Rights Plan to continue to operate for a brief period to reduce the risk that the auction might be ended prematurely.

Inco (Re)

Three weeks later, the same Commission panel made an order lifting the shareholder rights plan of Inco Limited ("Inco") as against all bidders, including future bidders, in the face of an unsolicited bid made by Teck Cominco Limited ("Teck").

Facts

Inco had in place a shareholder rights plan ("Inco Rights Plan") dated September 14, 1998. The Inco Rights Plan allowed existing shareholders, other than the bidder, to purchase additional Inco shares at a deep discount should a bidder acquire 20% or more of the outstanding shares of Inco unless the bid was a 'permitted bid'.

On May 8, 2006, Teck made an unsolicited bid for Inco for both cash and share consideration (the "Teck Offer"). It was conditional on Inco not acquiring Falconbridge. The Teck Offer met all requirements for a 'permitted bid' except that it did not allow for the take-up of additional shares deposited after the first take-up of shares because of concerns that such a condition may violate U.S. securities law. On May 29, 2006, Inco's board of directors ("Inco Board") advised shareholders to reject the Teck Offer. Teck subsequently received approval from the U.S. Securities and Exchange Commission to allow multiple take-ups in its bid, and in response Teck revised its offer so that it conformed to all the requirements of a 'permitted bid.' Inco argued that that for a bid to be considered a 'permitted bid' under the Inco Rights Plan, it needed to be a 'permitted bid' from the start.

On June 26, 2006, Inco, Falconbridge and Phelps Dodge announced they had entered into several agreements including the proposed combination of Inco and Phelps Dodge (the "Phelps Dodge Arrangement"), under which Inco would become a fully-owned subsidiary of Phelps Dodge. This proposed combination was subject to regulatory and shareholder approval. Under the terms of the Phelps Dodge Arrangement, the Inco

Board agreed not to solicit any proposals or discussions for alternate acquisition transactions. The transaction was not conditional upon Inco completing its bid for Falconbridge.

On July 13, 2006, Teck applied to the Commission for an order pursuant to section 127 of the *Act* to cease trading of any securities issued under or in connection with the Inco Rights Plan. On the eve of the hearing, the parties jointly presented the Commission with a draft form of the order. The draft order provided that the Inco Rights Plan would be lifted on August 16, 2006, as against Teck only. This date was selected because Xstrata's bid for Falconbridge expired on August 14, 2006. The Commission agreed with the date but ordered that the Inco Rights Plan cease to apply to all bidders and not just Teck.

The Commission's Analysis

The Commission again noted that the primary objective of the regulation of take-over bids is "the protection of the bona fide interest of the shareholders of the target company." The secondary objective is to provide a framework "within which take-over bids may proceed in an open and even-handed environment." In achieving those goals, "rights plans are tolerated, not promoted, and then only to the extent that they allow a board of directors of the target company to fulfil its fiduciary duty."

The Commission found that there was a real possibility that other bidders would emerge to acquire Inco on a standalone basis (that is, not contingent on Inco's acquisition of Falconbridge) other than Phelps Dodge. The Commission was concerned that provisions of the Phelps Dodge Arrangement prevented the Inco Board from soliciting or encouraging other offers which, along with provisions that waived the Inco Rights Plan for Teck only, would effectively prevent any other parties from entering the auction.

In an effort to ensure that Phelps Dodge and Teck were not in a privileged position because of the Inco Rights Plan, the Commission required that the plan be lifted with respect to all bidders. The Commission did not agree that an Order lifting the plan with respect to all potential acquirers would leave Inco shareholders vulnerable to coercive or unfair bids.

Ventas Inc v. Sunrise Senior Living Real Estate Investment Trust
[2007] O.J. No. 108
Ontario Court of Appeal
March 23, 2007

The Ontario Court of Appeal confirmed that parties to an auction process will be held to the terms of standstill agreements that preclude the consideration of post-auction bids where such agreements were clear and unambiguous and otherwise fair within the overall framework of an auction process designed to maximize shareholder value. As a general proposition, terms in standstill agreements containing restrictions on post-auction bidding do not conflict with directors' fiduciary duties and will not be struck out on that basis.

Facts

In November 2006, the board of trustees of Sunrise Senior Living Real Estate Investment Trust ("Sunrise REIT") initiated an auction process. Parties that were interested in exploring a possible acquisition were asked to sign a confidentiality agreement prior to being given access to confidential information. These confidentiality agreements, including those signed by two participants, Ventas, Inc ("Ventas") and Health Care Property Investors ("HCPI"), included a standstill provision preventing bidders from attempting unsolicited take-over bids.

However, the two agreements differed in respect of the termination of their standstill provisions. Ventas' agreement with Sunrise REIT provided that it would terminate at the end of the auction process. HCPI's agreement did not contain this term or provide for a release from the standstill in the event that Sunrise REIT agreed to an acquisition by a third party.

Following a first round of bidding, Ventas and HCPI were invited to participate in the "final" round of the auction. After HCPI withdrew from this process, Sunrise REIT entered into a purchase agreement with Ventas, accepting its proposal for C$15 per unit (the "Purchase Agreement"). The Purchase Agreement contained a clause that prohibited Sunrise REIT from amending, modifying, waiving or failing to enforce any of the standstill provisions or other conditions included in any of the confidentiality agreements.

HCPI then offered to enter into direct negotiations with Sunrise REIT in order to acquire it for C$18 per unit. In response, Ventas commenced

a proceeding to enforce the term in the Purchase Agreement which required Sunrise to enforce HCPI's standstill provision. Sunrise REIT opposed this proceeding, and submitted that Ventas should have used express language in the Purchase Agreement had it wanted to exclude a person who had been involved in the auction.

Decision in First Instance

The Superior Court held that section 4(4) of the Purchase Agreement, which imposes an obligation on Sunrise REIT to enforce the standstill provisions of its confidentiality agreement with third parties, was clear and unambiguous. It also found the contractual provision fair, in that it afforded Ventas a reasonable form of protection while allowing Sunrise REIT to consider offers from third parties that were not subject to standstill provisions. It therefore rejected an interpretation that would cause that obligation to become ineffective.

The Decision of the Ontario Court of Appeal

The Ontario Court of Appeal upheld the decision of the Superior Court of Justice and noted that the Sunrise REIT board had fulfilled its fiduciary duties when it set up the auction process because the auction process itself was designed to maximize price. The "fiduciary out" clause, which allowed Sunrise REIT to consider superior offers, was found to add integrity to the auction process even if it prohibited the Sunrise REIT board from considering offers from those who had bound themselves by through standstill agreements initially during the auction process. The judges noted that Sunrise REIT shareholders were free to vote against the Ventas transaction if they became convinced that the HCPI offer was superior.

Quebecor Media Inc. v. Osprey Media Income Fund
[2007] O.J. No. 3070
Ontario Superior Court of Justice
July 26, 2007

The Ontario Superior Court of Justice considered the appeal decision in *Ventas*, upheld the auction process established by the Osprey board, and found that the board's acceptance of a competing bid after the auction process was not a breach of the standstill agreement or a failure to inquire into the *bona fides* of a competing bid. There was no breach of fiduciary duty or failure to take reasonable steps to maximize shareholder value.

Facts

Osprey had initiated an auction process in March 2007 when it invited interested parties, including Quebecor Media Inc. ("Quebecor") and Black Press Ltd. ("Black Press"), to sign confidentiality and standstill agreements. These agreements were similar to the one entered into by Ventas in the *Sunrise REIT* case and provided for a release from the standstill in the event that Osprey agreed to an acquisition by a third party wanting to acquire 20% or more of its securities or assets.

In May 2007, Osprey and Quebecor entered into a support agreement which provided for an acquisition price of C$7.25 per unit. This support agreement, unlike the one entered into between Ventas and Sunrise REIT, contained a "spring clause" permitting Osprey to accept a better offer from any party who would otherwise be bound by a standstill clause after the first round of bidding was completed.

Black Press made a subsequent proposal for C$8.25 per unit. Quebecor applied to the court for judicial determination that Osprey and Black Press were in breach of their contractual obligations in connection with the auction process and that the Black Press bid was not a superior proposal.

The court found that there was no breach of the support agreement in light of its "spring clause" which released the parties from the standstill agreements when the Quebecor offer was accepted and announced. In this case, Quebecor had not negotiated or received protection against its competitors in the second round of the auction process. The intention of the parties was that Osprey would be free to respond to an unsolicited but "superior offer" subsequent to entering into the acquisition agreement with Quebecor and it was on this basis that Quebecor negotiated, and received, a substantial termination fee. There was no basis for the court to refuse to uphold the contractual arrangements the parties had negotiated.

Aurizon Mines Ltd. v. Northgate Minerals Corp
[2006] B.C.J. No. 1584; affirmed [2006] B.C.J. No. 2070
British Columbia Court of Appeal
July 14, 2006

This decision of the British Columbia Court of Appeal demonstrates that courts will enforce the terms of confidentiality and standstill agreements even if doing so precludes shareholders from considering or tendering

to a hostile takeover bid. In particular, courts will not permit a party to benefit from its own breach of such a contract.

Facts

Aurizon Mines Ltd. ("Aurizon") and Northgate Minerals Corp. ("Northgate") had entered into reciprocal confidentiality and standstill agreements with a term of one year while examining the possibility of a business combination. Northgate agreed that it would not acquire any of Aurizon's voting securities or communicate with Aurizon's shareholders for a period of one year. The parties had not exchanged any confidential information when, five months later, Aurizon informed Northgate that it was no longer interested in pursuing a business combination. Two months later, and while the standstill agreement was still in effect, Northgate launched a take-over bid with a closing date of July 7, 2006. Aurizon filed an application seeking a declaration that the standstill agreement was still in effect and an injunction preventing Northgate from completing its takeover bid until its expiry.

The trial judge rejected Northgate's arguments, holding that the unambiguous standstill provisions were binding and enforceable, despite there not having been any exchange of confidential information. Aurizon had not breached or repudiated the agreement when it suspended its interest in a business combination and Northgate had no legal basis to consider the agreements terminated at that time. The standstill agreement was clear that both parties needed to consent in writing to abridging the standstill period.

The judge further commented that when confidentiality and standstill provisions are bundled into one agreement, as is typically the case, the intent that the standstill applies only in the event that confidential information is provided must be stated explicitly, or else be a demonstrably implied term of the contract. The judge also held that Aurizon's silence could not be construed as a form of waiver or acquiescence.

Northgate pointed to the active trading in Aurizon shares since the announcement of the Northgate bid and argued that, as it has already commenced its takeover bid, shareholders would be prejudiced if this were enjoined. The court found that an injunction would not prejudice Aurizon's shareholders. Although the status quo had been altered by Northgate's breach of the standstill agreement, any prejudice in the

marketplace had been created by Northgate. The balance of convenience did not favour shareholders of Aurizon making their own determination of Northgate's offer; rather, it was in the interest of the public and the business community to enforce agreements which were intended to permit market participants to enter into meaningful discussions about corporate transactions without the risk of a hostile takeover bid.

The Court of Appeal upheld the decision and confirmed that Northgate could not put forward the consequences of its own breach to excuse its non-performance.

Sterling Centrecorp Inc. (Re)
[2007] O.J. No. 3072
Ontario Superior Court of Justice
July 26, 2007

Sterling Centrecorp Inc. ("Sterling"), a real estate investment and management services company, sought approval of a plan of arrangement for a going-private transaction that was opposed only by First Capital Realty Inc. ("First Capital"), a minority shareholder which had made a conditional takeover bid for Sterling's common shares. The plan of arrangement had been approved by a majority of the shareholders and by a majority of the minority shareholders.

First Capital argued that the plan of arrangement should not be approved in light of its outstanding higher bid, and because the process followed by the directors and Special Committee did not seek to maximize shareholder value. The court rejected First Capital's arguments and approved the plan of arrangement, noting that directors' obligations to maximize shareholder value does not mean simply being responsive to the possibility of a higher price without any assessment of the risk associated with the higher offer.

This decision also suggests that those who challenge the fairness of an existing bid based on a valuation and fairness opinion should do so after obtaining a valuation and fairness opinion of their own.

SCI Acquisition's Plan of Arrangement

SCI Acquisition, a vehicle owned by four management insiders of Sterling and who together controlled approximately 35% of Sterling's common shares, proposed to acquire the remaining Sterling shares for $1.26

per share. On February 28, 2007, Sterling and SCI publicly announced that they had entered into an Arrangement Agreement in respect of a Plan of Arrangement. The Arrangement Agreement provided that the securityholders entitled to vote must authorize and approve the Plan of Arrangement by two-thirds of the votes cast, and by a simple majority of the votes cast by securityholders who were not members of the acquisition group. The Arrangement Agreement and the Plan of Arrangement provided that securityholders had the right to dissent and require the company to purchase their shares for fair value.

After the announcement of the Arrangement Agreement, SCI Acquisition also sought to enter into support agreements with each shareholder in order to ensure shareholder approval for the going-private transaction. The support agreements were intended to be "hard" or "irrevocable" lock-up agreements, and contained provisions that prevented shareholders from supporting a superior competing transaction unless SCI Acquisition elected it. The agreements also required that the shareholders vote in favour of the SCI Acquisition-elected transaction, and vote against any proposal made in opposition to or in competition with that transaction, regardless of whether the agreement with SCI Acquisition has been terminated.

The Sterling board of directors had previously established a Special Committee to, among other things, engage a professional valuator to prepare a formal valuation and a fairness opinion. The valuation conclusion provided that the fair value of the common shares was in the range of $1.15 to $1.27 and the consideration offered through the Arrangement Agreement was fair to the minority shareholders.

First Capital circulated press releases on April 25 and 28, 2007, indicating it had sent letters to the Special Committee in respect of a *conditional* proposal to acquire the outstanding securities of Sterling at a price of $1.62.

The going-private transaction was approved at a shareholders' meeting on April 30, 2007, and, by the time Sterling shareholders voted on the arrangement, owners of 60.3% of the shares not controlled by SCI Acquisition had entered into the support agreements.

On May 11, 2007, Sterling issued a Material Change Report indicating that it had received written notification from U.S. authorities of the filing

of a complaint against the company in respect of its mining operations in the State of Nevada.

On May 15, 2007, First Capital publicly issued an offer to purchase the securities of the company for $1.62 cash; the offer remained conditional and subject to First Capital's sole judgment. In its Director's Circular issued in connection with First Capital's bid, the directors unanimously recommended that securityholders not tender to it as a result of its highly conditional nature.

First Capital's application to the OSC

First Capital had rejected SCI Acquisition's offer and offered to acquire Sterling in a take-over bid for $1.62 per common share. First Capital applied to the Ontario Securities Commission seeking to exclude those shareholders who had entered into the lock-up agreements from the calculation of minority approval on the basis that these were joint actors with SCI Acquisition.

The Commission held that whether parties to a support agreement or lockup agreement are joint actors is not dependent on the nature of the agreement. Indicators that a party is a joint actor includes: the party had a role in structuring, planning or promoting the transaction, be receiving different consideration from other shareholders or be receiving an interest in a different security of the corporation after the transaction closes. In applying this test, the Commission found that Sterling's co-CEO was a joint actor because he had been a part of the original insiders' acquisition group and had, in that capacity, negotiated the offer price and helped structure, plan and promote the going-private transaction. As a result, his shares could not be voted along with the minority. However the Commission also held that there was insufficient evidence to find the other signatories joint actors, and ordered no relief in respect of those signatories. The OSC released this decision on June 4, 2007.

Application to approve the Plan of Arrangement

The application to approve the Plan of Arrangement was heard on June 14, 2007. First Capital argued that the arrangement should not be approved because its outstanding bid offered shareholders 29% more consideration and the bidding process was fundamentally flawed.

The court considered whether the Sterling directors exercised reasonable business judgment in proceeding with the shareholders meeting on April 30, 2007 in light of the First Capital press releases and in issuing a Director's Circular in respect of First Capital's offer. The court found that the directors had proceeded appropriately in appointing a Special Committee, obtaining a fairness opinion and recommending to minority securityholders to vote in favour of the Plan. It noted that there was no evidence to contest the process or the fairness opinion included in the Circular and that First Capital has not supplied a fairness opinion.

The court then considered First Capital's submissions that the auction process was unfair because the Special Committee did not "test the market" and only considered the going-private transaction without approaching a third-party buyer. First Capital argued that this "blinkered approach" to change of control transactions is inconsistent with the directors' obligations to maximize shareholder value.

After noting that First Capital's bid always remained highly conditional, the court held that acting in a *bona fide* business judgment manner does not mean simply being responsive to the possibility of a higher price without offering any further assessment of the risk associated with the higher offer. After reviewing the process undertaken by the Directors and the Special Committee stated in the Directors' Circular, the court concluded that the Sterling Directors behaved in a *bona fide* manner. The court noted: that Sterling's assets are illiquid, making a competitive bidding process difficult; that SCI Acquisition controlled more than one-third of the outstanding shares such that the company was never "in play"; and that the First Capital bid was highly conditional. The exercise of business judgment by the Directors was within a range of reasonableness.

Scion Capital, LLC v. Gold Fields Ltd.
[2006] O.J. No. 466
Ontario Superior Court of Justice
February 6, 2006

Scion Capital, LLC v. Gold Fields Ltd.
[2006] Y.J. No. 17; affirmed [2006] Y.J. No. 11
Yukon Territory Supreme Court
February 24, 2006

Decisions from courts in Ontario and Yukon arising from Bolivar Gold Corp.'s Plan of Arrangement with Gold Fields Limited (the "Plan of Arrangement") made important findings with respect to claims and remedies related to insider trading and the approval of plans of arrangement.

These related decisions demonstrate that courts will be reluctant to interfere with the properly exercised decisions of a majority of securityholders. As a result, disgruntled minority shareholders may be better off invoking dissent rights rather than directly attacking a resolution that passes with a super-majority.

Facts

Bolivar Gold Corp ("Bolivar"), a gold exploration, development and production company incorporated under the *Yukon Business Corporations Act* ("*YBCA*"), was listed on the Toronto Stock Exchange ("TSX"). Gold Fields Limited ("Gold Fields"), one of the world's largest gold exploration, development and production companies, approached Bolivar in November 2003 to purchase its equity. Discussions continued between Bolivar and Gold Fields over the course of the next two years. During that time, three other corporations explored a purchase of Bolivar but no agreements were reached.

On November 18, 2005, Gold Fields approached Bolivar with an offer and asked for a response by November 21, 2005. Negotiations ensued and a Letter Agreement was signed on November 21, 2005 (the "Letter Agreement"). The Letter Agreement was finalized after receiving an oral fairness opinion from GMP Securities Ltd. ("GMP"). The Letter Agreement was approved by the Bolivar board of directors; however, the non-

management directors abstained until an independent valuation was completed.

The Letter Agreement contained a termination fee of $12 million and also required the Bolivar board of directors to give its unanimous approval of the Letter Agreement after obtaining an independent valuation. The Bolivar board also entered into voting agreements with Gold Fields. On November 21, 2005, Gold Fields and Bolivar issued a press release announcing the Letter Agreement but did not disclose the termination fee or the voting agreements.

The non-management directors formed an independent committee which was represented by independent counsel. The committee retained Sprott Securities Inc. ("Sprott") to provide an independent valuation (the "Sprott Valuation"). The Sprott Valuation used a range of gold prices of $400-$550US. The Sprott Valuation concluded that the fair market value of Bolivar shares was in the range of $2.65-$3.25. As Gold Fields was a shareholder and joint venture partner with Bolivar, the Sprott Valuation also determined that other parties would be deterred from launching competing bids.

On December 1, 2005, an Arrangement Agreement was executed and announced. The Bolivar board unanimously approved the Plan of Arrangement as set out in the Arrangement Agreement. The Plan provided for Gold Fields to pay amounts ranging from $3.00 per Bolivar share to $0.40 per Bolivar Series B Warrant to Bolivar securities holders.

Scion Capital LLC along with Scion Qualified Value Fund, A Series of Scion Qualified Funds, LLC and Scion Value Fund (collectively known as "Scion") and other Bolivar shareholders opposed the Plan of Arrangement, arguing that $3.00 per share was not adequate consideration. The price of gold at November 30, 2005 was $493 and rose to $547 by January 11, 2005. Both Scion and Gold Fields began purchasing additional voting shares of Bolivar after the Letter Agreement was announced.

On January 11, 2006, Gold Fields and Bolivar announced that Gold Field would increase the consideration to a range of $3.20 for a share to $1.00 for a Series B Warrant.

At the Special Meeting, held January 12, 2006, 76.65% of the shares and 82% of the warrants voted were in favour of the Arrangement Resolution.

Thus, the Plan of Arrangement received its required securityholder approval.

Scion subsequently opposed the approval of the Plan of Arrangement in the Yukon Territory Supreme Court on the grounds that the Plan, along with the actions of Gold Fields and the board, was oppressive to minority shareholders. Scion also made an application in Ontario seeking a declaration that Gold Fields and Bolivar violated the insider trading provisions of the *Act* by purchasing shares after announcing the Letter Agreement.

Both the Ontario Court and the Yukon Court dismissed Scion's complaints.

Ontario Application

In the Ontario application, Scion alleged that Bolivar and Gold Fields violated the insider trading provisions of the *Act* by allowing Gold Fields to purchase additional shares of Bolivar after entering into the Letter of Agreement. Scion also sought a declaration that Gold Field should be prohibited from dealing with these securities, and that two categories of shares were voted improperly. The crux of Scion's argument was that Gold Fields purchased these additional shares without the public disclosure of the termination fee or the agreement made between Gold Fields and Bolivar.

The court found that the remedy sought was not consistent with that of the *Act*, which provided for a remedy of damages for insider trading, and noted that Scion had not engaged the insider trading provisions to seek compensation for benefits received as a result of insider trading. It noted that Scion had bought shares during the period the alleged 'insider trading' took place; and, further, that rather than depress the price of Bolivar's shares, the share price actually increased. Scion therefore did not suffer any damages.

Scion also sought a declaration that the take-over bid provisions of the *Act* had been violated. As a majority of the shareholders had approved the Plan of Arrangement, the court declined to rule on this aspect of the application, saying that the issue was moot. Further, had there been a violation, the most extreme remedy would have been to restrict the voting of particular Gold Fields' shares in Bolivar. As the Arrangement

Resolution would have passed even if these shares were discounted, Scion's application was dismissed in its entirety.

Yukon Action

The Yukon Court reviewed the test for approving a Plan of Arrangement which held that the only aspects that were contested on the application were whether there had been compliance with the *YBCA* and whether a business person would reasonably approve the arrangement.

Compliance with YBCA

The court noted that although compliance with the *YBCA* is required, it must take a flexible approach when assessing compliance. The main role of the court is to determine whether the Plan of Arrangement is unfair. Non-compliance with the *YBCA* will be relevant if the arrangement itself is unfair; however, non-compliance does not in itself create unfairness.

Management Directors Conflicts

Scion argued that management was conflicted in recommending the Plan of Arrangement due to the termination payments, bonuses and ability to exercise their stock options these would receive should the Plan of Arrangement be approved. Scion also argued that the voting agreements were further evidence of the conflict.

The court held that all the benefits to the management directors were properly disclosed and Bolivar securityholders could have determined they were excessive when voting on the Plan of Arrangement. Thus, they were inconsequential in determining the fairness of the Plan.

Letter of Agreement

Scion also argued that the Letter Agreement was flawed as it committed Bolivar to a termination fee of $12 million before an independent committee could evaluate the agreement. Further Scion objected to the fact that the press release did not mention the termination fee. Scion also suggested that GMP and Sprott were not independent valuators.

The court agreed that it would have been preferable for the Sprott Valuation to have been made prior to the Letter Agreement being signed and found that the process used to arrive at the Letter Agreement was not perfect. However, as the Arrangement Agreement was unanimously approved by all the directors of Bolivar, the process by which the Letter Agreement was arrived at should be given little weight. The court also

noted that no evidence suggested that GMP or Sprott was tainted or conflicted in any way.

Fairness of the Arrangement Agreement

Scion's major argument was that the Plan of Arrangement did not offer a fair price to Bolivar securityholders. Scion furnished as evidence an expert independent valuation prepared by Blair Franklin, dated January 17, 2006 ("Blair Valuation"). The Blair valuation found a higher fair value range for the Bolivar securities than that of the Sprott Valuation. This was in part due to the rise in the price of gold since the Sprott Valuation.

The court noted that there is no statutory obligation for a corporation to furnish a more up-to-date valuation of its securities prior to a Special Meeting. An important indicator that a share value is fair is the judgment of the securityholders at the Special Meeting. As a substantial majority in both voting classes approved the Plan of Arrangement, it can be found that the prices offered by Gold Fields were within the fair range.

Yukon Court of Appeal

The Yukon Court of Appeal upheld the lower court's decision. The Court of Appeal noted that Scion essentially disagreed with the business judgment of the directors and the will of the majority. As the management directors were not in a position of conflict and a majority of the securityholders approved the plan, the reasonable expectation of the securityholders was met. Thus, the Plan of Arrangement was properly approved by the court.

Bingham v. Ashton Mining of Canada Inc.
[2007] B.C.J. No. 410
British Columbia Superior Court
March 1, 2007

The court considered various objections to a going private transaction. In rejecting all objections, the court made several important findings with regard to equivalent values in going-private deals. This decision also demonstrates that lock-up agreements with major shareholders will not necessarily disadvantage minority shareholders such that a pure majority of the minority vote is required. Additionally, formal valuations will be accorded greater weight by the court than inadequacy reports. Finally, the court may look to the actions of sophisticated shareholders during take-over bids which may also be taken as indicia of the fairness of the bid.

Facts

Ashton Mining of Canada Inc. ("Ashton") was a publicly traded company in the diamond exploration business. In 2000, Rio Tinto, through wholly owned subsidiaries or affiliates, acquired 51.7% of the shares in Ashton. For several years, Rio tried to attract interest in its Ashton shares but failed to generate any bidders. In 2004, it began discussions with Stornoway Diamond Corporation ("Stornoway"). On July 21, 2006, Rio Tinto and Stornoway entered into a lock-up agreement (the "Lock-up Agreement") whereby Stornoway agreed to make a take-over bid of Ashton if Rio Tinto tendered into the bid all of its shares in Ashton.

The Lock-up Agreement provided that Stornoway would make a bid to all Ashton shareholders to acquire Ashton shares. Shareholders who tendered into the bid could opt to be paid $1.25 cash per Ashton share tendered or could be provided one Stornoway share, valued at $1.24, plus $0.01 in cash. Should the demand for cash payment exceed $59.5 million, Stornoway would pay a pro-rated cash amount for each Ashton share tendered as well as provide a fraction of a Stornoway share.

By signing the Lock-up Agreement, Rio Tinto agreed that it would tender all its shares into the bid at $1.25 per share. Rio Tinto could not sell its shareholdings to another bidder and had to vote its Ashton shares against a competing proposal should one be made.

On July 24, 2006, Stornoway announced its intention to make an offer to purchase all of the issued and outstanding shares of Ashton at $1.25 per share. This offer price was 15% above the going market price. On August 10, 2006, Stornoway issued its circular in respect of the bid. The circular outlined what action Stornoway would take if it did not obtain 90% of the issued and outstanding shares of Ashton, including its intention to vote all the shares acquired during the first step in any second step amalgamation vote.

The Stornoway bid was the only bid in play, and Ashton's directors were concerned they had to maximize their shareholders' value. They commissioned a report from National Bank Financial Inc., which was not an opinion on the fair value of Ashton's shares; instead, it assessed whether Stornoway's offer was adequate. The report concluded that it was not ("Inadequacy Report").

The Stornoway bid was the only bid in play. Despite the Inadequacy Report, 68% of Ashton's shares, including those owned by Rio Tinto, were tendered into the bid. Thus, Stornoway proceeded to the second step transaction. In preparation for the amalgamation vote, the Ashton board of directors created a committee of independent directors to review and negotiate the amalgamation. The committee commissioned Sprott Securities Inc. to provide a formal valuation of Ashton and its shares and to evaluate the fairness of the consideration to be received by the minority shareholders ("Sprott Valuation").

The Sprott Valuation opined that the fair market value of Ashton shares was in the range of $0.91 to $1.35 per share and that the consideration to be received by the minority shareholders was fair. The committee recommended that shareholders vote in favour of the amalgamation.

The amalgamation vote was held on January 15, 2007. Approximately 96.5% of the shareholders voted in favour amalgamation; even discounting those Stornoway votes attached to the old Rio Tinto shares, 90% voted in favour of amalgamation. Removing all the Stornoway votes, including those attached to shares tendered by non-Rio Tinto shareholders in the first step of the transaction, 54% voted against amalgamation.

Bingham seeks to cancel the amalgamation

Matthew S. Bingham ("Bingham"), a minority shareholder in Ashton, brought a petition seeking declarations and restraining orders which would effectively cancel the amalgamation. Bingham's main complaint was that Stornoway should not vote the shares it acquired from Rio Tinto or other Ashton shareholders during the first step of the transaction in the amalgamation vote as the shares were not "minority shares" pursuant to Rule 61-501.

Equivalent Value in a Going Private Transaction

The court first considered whether the Stornoway bid was a 'going private transaction'. If it was not, then all that the Canadian Business Corporations Act ("CBCA") required to effect the amalgamation was a 66% vote in favour with no requirements with respect to the minority shareholders, and Bingham's arguments relating to Stornoway's participation in the minority vote were moot.

Section 3(1) of the CBCA Regulations defines a going private transaction as one that (1) results in the interest of a shareholder being terminated without the consent of the shareholder and (2) "without the substitution of an interest of equivalent value in participating securities of the corporation or of a body corporate that succeeds to the business of the corporation." As the amalgamation did effectively terminate the interest of those Ashton shareholders against the bid without their consent, the first part of the going private definition was met.

With respect to the second part of the definition, Stornoway shares were valued at $1.24 each whereas the bid valued the Ashton shares at $1.25 per share. Thus, Stornoway shares were not monetarily equivalent to Ashton shares. The court then considered whether "equivalent value in participating securities" related to the voting rights attached to the shares and not the monetary value of the share. Since so many Ashton shares were acquired in the takeover, those who opted for all-cash consideration had to receive the pro-rated cash payment and fractions of Stornoway shares which do not have the voting equivalent of an Ashton share. Thus Ashton shareholders were given neither the monetary nor the voting equivalent of Ashton shares making the deal a going private transaction.

Minority Approval

Under Rule 61-501, Stornoway could use the votes attached to the shares it acquired in the first step of the transaction in the amalgamation vote only if it was not joint actor with Rio Tinto. Bingham argued that Rio Tinto and Stornoway were joint actors as they entered into a 'hard' lock-up agreement where Rio Tinto could only sell its shares to Stornoway and had to vote in favour of the Stornoway proposal. Bingham also argued that Rio Tinto received Stornoway shares as consideration for its Ashton shares, giving it a vested interest in the amalgamation.

The court noted that if a shareholder who makes such a lock-up agreement is taken to have acted jointly with the bidder such that bidders are not allowed to vote shares acquired via a lock-up agreement, enthusiasm for takeover bids would be stifled. Thus, determination of joint actorship cannot be made out solely by the existence of a lock-up agreement.

Although the Lock-up Agreement prevented Rio Tinto from selling its Ashton shares to anyone other than Stornoway, it was not auction-

inhibiting. The agreement did not require anyone other than Rio Tinto to tender their shares and third parties could still make competing offers. The court found that the fact that no other buyers came forward suggested that Stornoway's offer was 'on the money'.

As Stornoway was publicly traded on the stock market, Rio Tinto could easily sell its shares in the company. No evidence was brought forward that Rio Tinto did anything other than convert the Stornoway shares to cash. Receiving shares as consideration for tendering into the bid was not sufficient to show that Stornoway and Rio Tinto were joint actors.

Oppression

Finally, Bingham argued that Rio Tinto, Ashton and Stornoway's actions must be viewed as oppressive. The court held that there was no foundation for finding oppression as "the bid, Ashton's response to the bid and the amalgamation vote were all carried out blamelessly."

The court noted that Bingham was sophisticated, was aware of the grounds upon which he thought the other parties were behaving badly well before the amalgamation vote and could have sought relief from the court prior to the shareholder's meeting. Thus, even if there were grounds to make a finding of oppression, the court would have declined to grant Bingham relief as he could have made an application at a much earlier point in time.

Finally, the court noted that rolling the amalgamation back would not be an appropriate remedy because Bingham was essentially seeking more money for his shares, a remedy that is available under the dissent provisions of the CBCA.

Ashton Mining of Canada Inc. v. Kwantes
[2007] B.C.J. No. 2010
British Columbia Superior Court
September 14, 2007

Following the amalgamation of Ashton Mining of Canada, certain shareholders sought to enforce their dissent and appraisal rights. By the time of hearing most dissenters had accepted the offer of $1.25 per share. Only shareholder Rumi Vesuna ("Vesuna") continued with the dissent action. The court dismissed Vesuna's application, holding that the $1.25 per share received was appropriate consideration.

Determining Fair Value

In determining the fair value of Ashton shares, the court accepted that four approaches may be taken to when valuing corporate shares: (1) the market value approach; (2) the asset value approach; (3) the earnings approach; and (4) some combination thereof. As Ashton's assets were all development or exploration assets and it did not derive income from its operations, the earnings approach was deemed inapplicable. Instead, the court found that fair value must be determined by some combination of the market value approach and the asset value approach.

Vesuna argued that the Inadequacy Report should be deemed accurate whereas the amalgamated corporation argued that the Sprott Valuation should apply. The court reviewed the methodology of both reports and ultimately discounted the Inadequacy Report as it used a less rigorous methodology than a valuation. National Bank Financial had also specifically stated in the Inadequacy Report that the report should not be considered a valuation of Ashton or its shares. The court found the Sprott Valuation to be detailed and persuasive and accepted its valuation and fairness opinion. The court also placed significance on evidence that Rio Tinto, a sophisticated investor, had accepted $1.25 per share as fair consideration.

The court dismissed Vesuna's further argument that Sprott was not an independent valuator. Vesuna's argument against Sprott's independence was based on Sprott acting as both a trader and a dealer in all major Canadian markets and as such, that it may have positions in securities of Ashton and Stornoway. The court noted that National Bank Financial and other institutional brokerage firms would be in the same position as Sprott had they prepared a formal valuation. Additional evidence would be required to show that a brokerage firm was not an independent valuator.

Independent Appraiser

Vesuna had requested that an independent appraiser be appointed to assist the court in fixing fair value. As the court had accepted the Sprott Valuation, if found the appointment of an appraiser was unnecessary. The court noted that appraisers should not be appointed when the dissenting shareholder provides no expert evidence. To do otherwise would encourage shareholders to bring frivolous dissent applications without having to adduce expert evidence themselves.

Silber v. DDJ Canadian High Yield Fund
[2006] O.J. No. 2503; affirmed [2007] O.N. No. 1581
Ontario Superior Court of Justice
June 19, 2006

This decision confirms that corporate law dissent and appraisal rights are not available to those who hold units in a closed-end investment fund. However, the court made *obiter* comments to suggest that it may be logical to suppose that corporate law will be developed, over time, to grant unit holders of income trusts some rights and remedies analogous to those granted by statute to shareholders of business corporations. This decision was upheld on appeal to the Ontario Court of Appeal.

Facts

The DDJ Canadian High Yield Fund is a closed-end investment fund (the "Fund") publicly traded on the TSX. It was established by way of a Trust Agreement between C.I. Mutual Funds Inc and The Trust Company of the Bank of Montreal. The manager of the fund scheduled a special meeting of the unit holders to seek approval of an extraordinary resolution to amend the investment strategy of the Fund and to extend the Fund's term. More than two-thirds of the unit holders voted in favour of the extraordinary resolution.

Arthur Silber ("Silber") had purchased approximately 69,600 units of the Fund between August 15, 2005, after notice had been given regarding the extraordinary resolution, and September 2, 2005. In a letter to the Fund manager dated September 2, 2005, Silber objected to the proposed extraordinary resolution and requested that his units be redeemed as of the date of the meeting based on the net asset value ("NAV") per unit. The Fund manager denied this request. Silber subsequently filed a Statement of Claim seeking remedies available under corporate law dissent provisions. In response, the Defendants brought a motion to strike out the Statement of Claim alleging that it failed to disclose a reasonable cause of action.

Decision in First Instance

The Court found that Silber had no contractual basis for his claim. Neither the Trust Agreement nor the Prospectus conferred dissent or redemption rights to unit holders who objected to an extraordinary resolution. Further, such rights could not be interpreted as an implied term because doing so

would contradict the redemption provisions of the Trust Agreement that permitted redemption of units only upon termination of the trust. Silber also failed to meet any of the requisite criteria for importing an implied term into a contract.

Silber conceded that there was no legislative basis in the corporate law statutes to support his claim to dissent and appraisal rights because the corporate law statutes did not extend those remedies to closed-end investment funds. However, Silber argued that the remedies he sought were analogous to the remedies provided by way of statute to corporate shareholders.

The Court did not agree with Silber's arguments, noting that investment trusts are totally distinct entities from corporations. The remedies and rights Silber sought (*i.e.* protection of minority shareholders, dissent and appraisal rights) are "creature[s] of statute" and were not provided for by an extension of common law principles. While the court did note that it was logical to assume that the law will be developed to grant unitholders of income trusts some rights and remedies analogous to those granted by statute to shareholders of business corporations, as these were comparable vehicles, the same was not necessarily true of holders of closed-end investment funds.

The court did not find that the redemption provisions of the Fund were unconscionable or inequitable or constituted oppressive conduct. Furthermore, Silber knew when he purchased his units on the open market that these traded at a discount to the NAV, and that these units were transferable but not redeemable. Silber had no reasonable expectation that the units could be redeemed prior to the termination of the Fund or that a minority unitholder would be afforded any dissent rights in the event of an extraordinary resolution.

The Decision of the Court of Appeal

In a unanimous and brief decision, the Ontario Court of Appeal upheld the decision of the lower Court, noting that it agreed with "the decision of the motion judge and with the reasons he gave."

Manitoba (Securities Commission) v. Crocus Investment Fund
[2007] M.J. No. 87; affirmed [2006] M.J. No. 30 (MCQB)
Manitoba Court of Appeal
March 30, 2007

The Manitoba Court of Appeal addressed whether and when under Manitoba's corporate statue (which does not include separate provisions for advances such as the CBCA) it is appropriate for a corporation which is not insolvent, but is under the control of a receiver, to advance funds to pay for ongoing legal defense costs incurred by its former directors and officers prior to the conclusion of those legal matters. This decision confirms a corporation may do so even when it and those former directors and officers are the subject of regulatory proceedings and shareholder class action litigation, subject to certain rights of reimbursement. The interests of other stakeholders, including shareholders, were met by requiring the former directors and officers to provide undertakings promising repayment if it subsequently developed that he or she was not entitled to payment.

Facts

In 2005, Crocus Investment Fund ("Crocus") became the subject of an investigation by each of by the Manitoba Securities Commission ("MSC") and Manitoba's Office of the Auditor General. The MSC issued a statement of allegations which alleged improper conduct on the part of Crocus and its officers and directors. The Board of Directors ultimately resigned en masse in June 2005. As a result, on June 28, 2005, Deloitte & Touche Inc. ("Deloitte") was appointed Crocus' Receiver and Manager, although the company was still solvent.

Prior to being placed in receivership, Crocus had made arrangements to indemnify the officers and directors for the costs of legal counsel during the course of the various investigations. Crocus had a directors and officers liability insurance policy with Chubb Insurance Company of Canada that has a maximum of $5,000,000 ("Chubb Policy"). Crocus also had a corporate by-law ("By-law 1.7") which provided that officers and directors shall be indemnified against all costs, charges and expenses reasonably incurred in respect of any civil, criminal or administrative proceeding where the director or officer was made a party to the litigation by reason of their position and if the officer or directed acted honestly

and in good faith and if he or she had reasonable grounds for believing that her or his conduct was lawful (the "Indemnity Criteria").

Deloitte, upon being appointed Receiver, requested and received status reports from the officers' and directors' counsel which showed significant expenses had already been incurred. Deloitte then received a letter from the counsel of various shareholders stating that a class-action was being commenced and requesting that any indemnification of the directors and officers cease.

Deloitte applied to the court for an order authorizing Deloitte to pay any unpaid legal accounts incurred up to June 28, 2005 subject to certain rights of reimbursement, and an order authorizing Deloitte to refrain from paying claims for indemnify for further expenses incurred after June 28, 2005 until the completion of the MSC or class action proceedings or an order from the court requiring payment.

In its application, Deloitte stated that it interpreted By-law 1.7 to require that Crocus indemnify its former officers and directors provided their conduct meets the Indemnity Criteria. However, Deloitte argued that this obligation to indemnify did not require the immediate funding of their defenses on the basis that it remained uncertain whether the Indemnity Criteria were met. Deloitte argued it would best be able to assess whether indemnification is required upon completion of the proceedings.

The former directors and officers argued that they should be indemnified immediately. Although the MSC proceedings alleged conduct contrary to the public interest, no allegations were made that the directors and officers themselves acted dishonestly or contrary to Crocus' interest. The former directors and officers also highlighted that they had relied on legal advice when making their decisions.

Trial Court's Analysis

The trial judge found that the policy goals underlying indemnity provisions was to "allow for reimbursement for reasonable good faith behaviour, thereby discouraging the hindsight application of perfection." Without indemnification, strong candidates would be discouraged from seeking directorships.

The court determined that it had the discretion to decide whether those with a right to potential indemnification are entitled to ongoing payment

of costs rather than awaiting completion of the proceedings. In this case, the proceedings were complex, the former directors and officers had immediate need of representation and the corporation was not insolvent. The factors suggested that advances of legal fees to the former officers and directors was not inappropriate.

The court found that although reliance on legal advice in the performance of duties does not guarantee indemnification, reasonable reliance made in good faith will *prima facie* show that the director or officer met the Indemnity Criteria. As there was no evidence to show that the directors and officers had failed to meet the Indemnity Criteria, they were held to be entitled to ongoing indemnification of all reasonable defense costs.

Finally, the court determined that indemnities are not subject to shareholder rights. However, any indemnification is subject to a right of the company to reclaim the payments if it is subsequently shown that the Indemnity Criteria were not in fact met.

Court of Appeal

The Manitoba Court of Appeal upheld the trial court decision, substantially endorsing its reasoning. The Court of Appeal specifically noted that the board of directors of a corporation has wide-ranging authority to manage the corporation and it is within the power of the board of directors to direct that indemnification be provided on an ongoing basis. As the board of directors of a corporation has this authority, so does a receiver.

The decision to indemnify on an ongoing basis is “an interim financing decision” from the perspective of the corporation. The corporation would not necessarily be at risk as the directors and officers would have to repay any amounts advanced should it be shown that the Indemnity Criteria were not met.

Le Maitre Ltd. v. Segeren et al.

[2007] O.J. No. 2047

Ontario Superior Court of Justice

May 24, 2007

In this application for interim relief pursuant to the oppression provisions of the *Ontario Business Corporations Act*, the court confirms that it can apply the principles for granting interlocutory injunctive relief in the interests of the predictability and certainty in the law. However,

because there may be some circumstances where interim relief under the oppression remedy is merited absent all the traditional considerations associated with an interlocutory injunction, the court retains discretion to administer this remedy to obtain a fair result.

Facts

The Applicants in the proceeding included Le Maitre Limited ("LML"), a UK corporation that is a pyrotechnic product manufacturer, and individuals (together, the "UK Shareholders") that own 50% of the shares in one of the corporate respondents, 793862 Ontario Inc., a holding company ("Holding Company"). The corporate respondents included the Holding Company and various subsidiaries to the Holding Company.

In May of 1996, the UK Shareholders, Mr. Segeren ("Segeren") and the Holding Company entered into a Unanimous Shareholder Agreement ("USA"). One of the effects of the USA was to have the affairs of the Holding Company managed by a sole director, Segeren. The USA also provided that there was to be no material change in the nature of the business of the Corporation without the consent of not less than 75% of the shareholders in the Corporation. A Service Agreement established that Segeren, in his capacity as the Managing Director of the Holding Company, could not engage in any activities that may compete with the business of the Holding Company. Segeren's position as a sole director pursuant to the USA gave him effective and *de facto* control over the Holding Company and its subsidiaries.

Early in 2003, LML had entered into a distribution agreement with the subsidiaries of the Holding Company, under which these agreed to purchase pyrotechnic products exclusively from LML and agreed to refrain from manufacturing any pyrotechnic products.

In July 2004, the UK Shareholders became aware that one of the Holding Company's subsidiaries was manufacturing and distributing pyrotechnic products. The UK Shareholders also discovered that Segeren had entered into negotiations to acquire the assets and assume the lease of a manufacturing facility of Luna Tech Inc. ("Luna Tech"), an American pyrotechnic products manufacturer. Although neither the purchase agreement nor the lease assignment for the Luna Tech transaction had been signed, Segeren began operating the Luna Tech manufacturing

facility through one of the Holding Company's subsidiaries. Luna Tech admitted that it was insolvent.

The Applicants sought an injunction to prevent completion of the Luna Tech transaction. These argued that completing the transaction would contravene provisions of the USA, the Distribution Agreement and the Service Agreement, and would result in the manufacture of pyrotechnic products by the Holding Company subsidiaries in direct competition with LML. The proposed transaction also would result in a material change in the business of the Corporation, contrary to the terms of the USA. The proposed transaction would also expose the corporate respondents to the claims of Luna Tech's creditors.

Test for interim relief under the oppression provisions

The Court considered the appropriate test to be applied for granting interim relief under the oppression remedy and concluded that in the "interests of predictability and certainty in the law", the principles for granting interlocutory injunctive relief should be applied when interlocutory relief is sought under the oppression remedy. However, the court observed that there may be some circumstances where interim relief under the oppression remedy is merited in the interests of fairness absent all the traditional considerations associated with an interlocutory injunction. Reserving a discretionary power to forgo compliance with any one of the requirements to show a balance of convenience, irreparable harm or provide an undertaking as to damages permitted the court to achieve a fair result consistent with the broad nature of the oppression remedy.

In this case, Justice Pepall found that the applicants met the rest regardless of how it was framed, because the applicants had established a strong prima facie case of oppressive conduct. The existence of the USA, Distribution Agreement and Service Agreement between the parties informed the reasonable expectations of the shareholders of the Holding Company. The USA did not permit a material change in the nature of the business without shareholder approval, nor did it permit management of the Holding Company to enter into any contract with another party that would be considered out of the ordinary course of business. The Distribution Agreement contained a negative covenant that required the Holding Company's subsidiary to refrain from manufacturing any

pyrotechnic products; this covenant would be breached if the Luna Tech transaction closed. She therefore granted interim relief to the Applicants.

The court stated that it will not interfere lightly with the internal affairs of a corporation, but in the circumstances of this case, the business judgment rule is of little assistance. Segeren had unilaterally entered into purchase negotiations with Luna Tech without any consultation with nor approval given by any of the remaining 50% shareholders of the Holding Company. Doing so breached provisions of the USA, Distribution Agreement and Service Agreement. The business judgment rule could not be invoked to excuse these breaches of contract.

II. U.S. Cases

Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit
547 U.S. 71 (2006)
Supreme Court of the United States
March 21, 2006

A unanimous Supreme Court of the United States found that the *Securities Litigation Uniform Standards Act of 1998* ("*SLUSA*") barred claims by securityholders under state law – and not just claims by purchasers and sellers – and that such interpretation was consistent with its §10(b) (*Securities Exchange Act of 1934*) and SEC Rule 10b-5 jurisprudence.

Facts and lower court decisions

Merrill Lynch was the subject of an investigation by the New York Attorney General in 2002 following allegations that the firm produced biased investment advice to its investment banking clients. Although Merrill Lynch settled its dispute with the New York Attorney General, the investigation sparked several private securities fraud actions, including one initiated by Shadi Dabit ("Dabit").

Dabit, a former Merrill Lynch broker, alleged that the firm had breached the fiduciary duty and covenant of good faith and fair dealing that it owed its brokers. On Dabit's theory, Merrill Lynch first directed its analysts to release misleading research to the brokers, who relied on the research. Merrill Lynch then used its misinformed brokers to enhance the

prices of its investment banking clients' stocks. Dabit alleged that the misrepresentations caused brokers to hold overvalued securities, and that brokers lost commission fees when clients, after realizing their poor investments following the New York Attorney General's investigation once prices dropped, took their business elsewhere.

Instead of relying on federal securities laws, Dabit advanced his claims under Oklahoma state law. In this way, Dabit sought to avoid the heightened pleading standards required under federal class action law. Merrill Lynch filed a motion to dismiss Dabit's complaint on the basis that the *SLUSA* pre-empted his action. The District Court granted Merrill Lynch's motion, but this decision was reversed by the Court of Appeals for the Second Circuit.

The Supreme Court's Decision

The sole question before the Supreme Court was whether Dabit's complaint was one "in connection with the purchase or sale" of a security. Merrill Lynch argued that the language in the *SLUSA* of "in connection with" should be given a broad interpretation, thereby pre-empting holders as well as purchasers and sellers. In contrast, Dabit argued that the impugned phrase should be construed in accordance with *Blue Chip Stamps v. Manor Drug Stores* ("*Blue Chip Stamps*"), which limited the Rule 10b-5 private right of action to only purchasers or sellers.

Rejecting Dabit's arguments, the Supreme Court emphasized the federal interest in protecting the integrity and efficient operation of the market for nationally traded securities. In addition to §10(b) and Rule 10b-5, Congress had adopted the *Private Securities Litigation Reform Act of 1995* ("*Reform Act*") to stem vexatious use of class-action proceedings. Because the *Reform Act* placed special burdens on plaintiffs who sought to bring federal securities fraud class actions, some litigants avoided the federal forum altogether. After plaintiffs began bringing class actions under state law, often in state court, Congress enacted the *SLUSA* in 1998.

The Supreme Court stated that it would be counterproductive if the *SLUSA* did not pre-empt Dabit's complaint, as the purpose of the legislation is "to prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives" of the *Reform Act*.

In light of the legislative framework, the Supreme Court preferred a broad interpretation of "in connection with" that would include holders of securities. Justice Stevens distinguished *Blue Chip Stamps* by noting it relied on "policy considerations" when it limited the Rule 10b-5 right of action to purchasers and sellers; the decision did not purport to define the limits of the phrase "in connection with the purchase or sale." It is sufficient, in the context of the *SLUSA*, for the alleged fraud to "coincide" with the securities transaction and there is no requirement of an identifiable purchaser or seller.

Appreciating the concern that Congress should not cavalierly pre-empt state-law causes of action, the court indicated that the *SLUSA* does not pre-empt any state cause of action. Rather, it established a procedural bar to holders from using class actions for certain claims, and it would not affect any group of fewer than 50 plaintiffs.

This decision reaffirms that federal law, not state law, is the principal vehicle for asserting class-action securities fraud claims. Because the *SLUSA* was found to pre-empt holders' claims, the Supreme Court vacated the Second Circuit's decision, and the case was remanded for further proceedings in accordance with the Supreme Court's decision.

Tellabs, Inc. v. Makor Issues & Rights, Ltd.
Supreme Court of the United States
June 21, 2007

The Supreme Court of the United States considered the degree of particularity with which a plaintiff must plead facts in a securities fraud action. The *Reform Act* requires plaintiffs to state with particularity facts showing a state of mind on the part of the defendants to deceive. The court determined that a plaintiff will have pleaded facts with sufficient particularity if the inference of a defendant's mental state is at least as strong as any other plausible inference. However, concurring judgments and a dissent were issued, which interpreted the *Reform Act* as requiring a higher standard of pleading than a balancing of inferences for allegations of scienter.

Facts & lower court decisions

Shareholders who had purchased Tellabs, Inc. ("Tellabs") shares accused it and one of its executives, Richard Notebaert ("Notebaert"), of deceiving

investors about the shares' true value. Notebaert and Tellabs were alleged to have falsely reassured investors that there was a strong demand for Tellabs products when the opposite was true. After reaching a high of $67 during the alleged period of deception, the shares' value plummeted to a low of $15.87 after a series of reduced sales and revenue projections came to public knowledge.

Tellabs shareholders filed a class action in the District Court for the Northern District of Illinois, claiming that Tellabs and Notebaert had engaged in securities fraud in violation of §10(b) of the *Securities Exchange Act of 1934* and SEC Rule 10b-5. The District Court dismissed the complaint on the basis that the shareholders failed to plead facts with the requisite degree of particularity under the *Reform Act*. The Court of Appeals for the Seventh Circuit reversed the District Court's decision.

The Supreme Court adopts a comparative approach

The sole issue before the Supreme Court was how to assess when the facts pleaded in a securities fraud complaint amount to a "strong inference" of scienter. Scienter is "a mental state embracing intent to deceive, manipulate, or defraud." Under §21D(b) of the *Reform Act*, a complaint alleging that the defendant made false or misleading statements must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind".

Justice Ginsburg, for the majority of the Court, considered the *Reform Act*'s goal to curb vexatious litigation while preserving investors' ability to succeed on meritorious claims, and prescribed three guidelines for assessing whether a plaintiff pleaded a "strong inference" of scienter. The third guideline provided that the Court must take into account plausible opposing inferences. The inferences need not be irrefutable, but must be more than merely "reasonable" or "permissible". A complaint will survive only if a reasonable person would deem the inference of scienter to be at least as strong as any opposing inference. The court held that the use of this comparative inquiry would satisfy the heightened pleading requirements that Congress had demanded in the *Reform Act*.

The court refused to decide whether the shareholders' allegations led to a sufficiently "strong inference" of scienter. As neither the District Court nor the Court of Appeals had the opportunity to consider the matter in light of the appropriate analysis, the Supreme Court vacated the

appeal court's judgment and remanded the case for further proceedings consistent with its opinion.

Two judges delivered separate concurring reasons in which each framed the pleading standard differently. Justice Scalia stated the test should be whether the inference of scienter is *more plausible* than the inference of innocence. In his opinion, the majority's standard did not accord with Congress's intention when it chose the phrase "strong inference". Justice Alito agreed, and suggested that a "strong inference" of scienter must only arise from the facts that are stated "with particularity". Facts not stated with requisite particularity should not be considered in the analysis.

Justice Stevens wrote a dissenting opinion, interpreting "strong inference" to have the same meaning as "probable cause" in the criminal context. In view of this standard, Justice Stevens held that the shareholders had established probable cause that the respondents acted with the required intent.

Louisiana Municipal Police Employees' Retirement System
v. Edwin M. Crawford
2007), C.A. No. 2635-N
Court of Chancery, State of Delaware
February 23, 2007

The Delaware Court of Chancery issued a preliminary injunction postponing for at least 20 days a vote of the stockholders of Caremark RX, Inc. ("Caremark") on its proposed merger with CVS Corporation ("CVS"). While a vote postponement might not seem out of the ordinary, the Court's reasoning is notable because it emphasizes the importance of looking at the larger circumstances in determining whether sufficient disclosure has been made.

Chancellor Chandler declined to enjoin the merger despite finding certain improprieties in the structure of the merger which may have benefited directors and senior managers, explaining that "only in extraordinary circumstances" will the court "substitute its business judgment for that of directors, or usurp the rights of shareholders to make their own informed decisions". However, the judge considered the role of a special dividend in this stock-for-stock merger, observed that the merger

structure conferred appraisal remedies on shareholders, and noted that shareholders may have been deprived of sufficient information within the available disclosure to properly exercise available appraisal remedies.

Facts

On August 16, 2006, the management of Caremark met with its board to review strategic opportunities for the company. Management suggested that a potential business combination with a retail drugstore chain offered both strategic and financial opportunities for the company. Management eventually identified CVS as a strong potential merger partner.

On November 1, 2006, the boards of Caremark and CVS entered into a merger agreement that was subject to the approval of the shareholders of both companies. The transaction was structured as a no-premium "merger of equals" – a stock-for-stock merger in which neither side would be perceived as the acquiror and the combined entity would be owned in nearly equal proportion by its current shareholders. However, despite this structure, many Caremark directors and senior management stood to benefit personally: the merger constituted a "change of control" for most of Caremark's senior executive employment contracts, such that outstanding options would become immediately exercisable at the time of the merger and the merger agreement protected Caremark directors and officers from possible liability for option backdating.

The merger agreement also contained a number of deal-protection devices, including: 1) both boards had to submit the merger to their shareholders under a "force the vote" provision; 2) both boards were subject to a "no shop" provision, under which neither board could speak with a competing bidder unless a competing offer was either a "Superior Proposal" or would likely to lead to one; 3) a "last look" provision which obligated the target board to disclose the terms of a competing Superior Proposal and allowed the other party a five-day window in which to match the bid; and finally, 4) a $675 million reciprocal termination fee if either board withdrew or changed its recommendation of the merger. The termination fee would be paid if either company's shareholders rejected the merger agreement and then accepted any other merger proposal within twelve months.

On December 18, 2006, Express Scripts announced an unsolicited bid for Caremark. The Express Scripts offer valued Caremark at over $3 billion

more than the value under the CVS transaction, but was conditional on a due diligence review and antitrust approval. The Caremark board decided that the Express Scripts offer did not constitute a Superior Proposal.

CVS subsequently announced a special dividend which was to be declared by Caremark before the effective date of the merger and paid to Caremark's shareholders either at the time of, or immediately after, the merger. The dividend would be payable only if the merger were approved.

Following a proxy context between Caremark and Express Scripts for the votes of Caremark shareholders, certain shareholders of Caremark and Express Scripts sought an injunction preventing a Caremark shareholders' meeting to approve the CVS/Caremark merger. The plaintiffs contended that the individual defendants breached their fiduciary duties and failed to disclose to shareholders material information necessary to vote on the proposed transactions. The plaintiffs asserted that the individual defendants breached their fiduciary duties at least in part due to their personal interests in consummating the CVS/Caremark transaction.

Caremark issued supplemental disclosures in an attempt to render moot many of the plaintiffs' disclosure claims. Of the remaining disclosure claims, only the failure to disclose the structure of the investment banker's compensation was found to require additional disclosure. Chancellor Chandler found that the disclosure in this respect was misleading by omission, as it failed to disclose the initial requirement the bankers had to meet in order to receive their fees. Where a public announcement of a contemplated transaction is a prerequisite for receipt of fees, those fees are contingent upon initial approval of the transaction. It follows that where a significant portion of bankers' fees rests upon shareholder approval of a particular transaction, that condition must be specifically disclosed to the shareholder.

A second major issue in this case was whether the special cash dividend was merger consideration, thus entitling shareholders to appraisal rights. Chancellor Chandler noted that the label "special dividend" was simply "cash consideration dressed up in a none-too-convincing disguise". So long as payment of the special dividend remained conditional upon shareholder approval of the merger, Caremark shareholders should not be denied their appraisal rights.

Chancellor Chandler found that shareholders would suffer irreparable harm if they were to vote without knowledge of the material facts relating to the structure of bankers fees and, most importantly, knowledge of their entitlement to appraisal rights. The court postponed any vote of Caremark shareholders for at least twenty days until after proper disclosure on these issues was made.

By refusing to enjoin the merger, Chancellor Chandler underscored the courts' reluctance to intervene in corporate affairs unless shareholders are unable to provide for their own protection or properly exercise their rights. Courts will not enjoin a merger or a shareholders vote even if any of particular element of the deal may be unfair or presumptively coercive. Although serious questions remained regarding the process surrounding the merger negotiations, if shareholders were aware that appraisal rights remained available, shareholders fully apprised of all relevant facts could protect themselves.

In Re Netsmart Technologies, Inc. Shareholders Litigation
(2007) C.A. No. 2563-VCS
Court of Chancery, State of Delaware
March 14, 2007

The Delaware Court of Chancery again considered whether a company's merger vote should be enjoined, this time on the grounds that its auction process was flawed and that valuation information in the proxy was deficient. The court granted a preliminary injunction and delayed the shareholder vote on the merger until after the corporation's board disclosed to shareholders more complete information about why it ruled out a transaction with strategic buyers and the valuation of its future expected cash flows. The court declined to enjoin the vote until after the company conducted a search for strategic buyers.

Facts

In October 2005, Netsmart Technologies, a supplier in the healthcare information technology market, acquired its largest direct competitor. After the announcement of this acquisition generated interest among several private equity investors, James L. Conway ("Conway"), Netsmart's CEO, and William Blair & Co., L.L.C. ("William Blair"), Netsmart's investment banker, contemplated the possibility of a going private transaction.

On May 11, 2006, Netsmart's Executive Vice-President for Corporate Development, Kevin Scalia, presented three options to the Netsmart board: 1) continue as a public company; 2) sell the company to a strategic buyer; or 3) take the company private by selling to a private equity buyer. Scalia emphasized the value of the third option over the first. Following the meeting, Netsmart's management focused on the option of going private and did not explore the possibility of transacting with strategic buyers.

The board formed a Special Committee on July 13, and the company was marketed to seven private equity firms. Four of the seven firms responded. The two highest bidders were offered the opportunity to conduct further due diligence before making final bids. Francisco's final bid was $15 per share, while Vista's was $16.75 per share. The Special Committee continued to reject the possibility of a broader market canvass.

Insight, a third investor, had not been invited to the second round, but maintained an interest in the process. After Vista conducted further due diligence and declined to offer $16.75 per share, the Special Committee decided to give Insight an opportunity to conduct due diligence. Insight made an expression of interest at $16.40 per share on October 4, and after further negotiation, Netsmart executed an exclusivity agreement with Insight at $16.50 per share.

Netsmart and Insight began negotiating a merger agreement at the end of October 2006. The agreement prohibited the board from shopping the company but permitted it to consider a Superior Proposal. Netsmart would receive a one per cent break-up fee, but Insight would receive a break-up fee of three per cent. The merger agreement was executed on November 18, 2006, after William Blair presented its final fairness opinion.

The merger agreement was publicly announced on November 20, 2006. Netsmart's proxy statement was filed on February 28, 2007. The shareholders were to vote at a meeting scheduled for April 5, 2007.

Motion for an Injunction

Several shareholders filed a motion seeking a preliminary injunction against the completion of the merger. The plaintiffs claimed that the sales process was deficient because the Special Committee did not obtain the highest value from the private equity bidders that it had

solicited in the sales process. They also claimed that the board had acted unreasonably by failing to canvass the possibility of being acquired by strategic purchasers.

The defendants denied that strategic buyers would have been interested in Netsmart, noting that no offers from strategic buyers had emerged following the public announcement of the merger. Netsmart stated it used the limited auction among private equity investors to acquire a "bird in the hand" against which to evaluate a deal should a strategic buyer emerge. The defendants further argued that the inclusion of a break-up fee in the merger agreement served as a post-signing market check.

Vice Chancellor Strine rejected the plaintiffs' allegations that Conway had dominated the Special Committee and induced it to accept an inferior offer. Although the Special Committee had conducted itself in a way that may have aroused shareholder suspicion, the process had no adverse consequences on the bidding process.

However, Vice Chancellor Strine was critical of Netsmart's general decision not to explore a transaction with a strategic buyer. The board had assumed a *Revlon* duty once it decided to pursue a cash sale; as such, it was required to make a reasonable effort to maximize the return to Netsmart's investors. The defendants' attempt to rely on a post-signing market check as a means of stimulating a hostile bid by a strategic buyer did not satisfy the *Revlon* duty. Furthermore, by choosing the private equity route, management would be able to continue as executives and receive more equity. For all these reasons, the plaintiffs were found to have demonstrated a reasonable probability that the Netsmart board breached its *Revlon* duties.

The plaintiffs also argued the board made inadequate disclosure because the proxy failed to include: 1) Scalia's projections from May 11; 2) a complete set of the projections used by William Blair in preparing its discounted cash flow (DCF) valuation; and 3) instances in which certain members of the Special Committee had served on boards with Conway.

Vice Chancellor Strine stated that once a board raises a topic in its disclosures, a duty attaches to provide information that is "materially complete and unbiased by the omission of material facts." In this case, Netsmart was required to disclose the valuation methods that William

Blair used in its fairness opinion, as well as the key inputs and range of ultimate values generated by its analyses such as the DCF projections of revenue, cost or earnings estimates for Netsmart's performance in 2010 and 2011. However, as the May 11 projections were more pessimistic than those disclosed in the proxy, and were less favourable to the plaintiffs' position, they would not have a material effect on a shareholders' impression of the proposed merger and there was no duty to disclose them.

With respect to the plaintiffs' third disclosure concern, Vice Chancellor Strine acknowledged that it was colourable for Conway to have served on other boards with members of the Special Committee. Nevertheless, the court was reluctant to impose a requirement that such a relationship must always be disclosed.

Having found that aspects of Netsmart's limited auction process and proxy disclosure were deficient, the court held that the shareholders would suffer irreparable harm if the shareholder vote was conducted before further disclosure was made about the reasons for disregarding the possibility of finding a strategic buyer and the full William Blair revenue and earnings projections. However, Vice Chancellor Strine refused to enjoin the merger vote until such time that Netsmart conducted a search for strategic buyers. It would be sufficient for the shareholders to vote on the merger once they had received the additional information regarding the limited auction process and proxy disclosure.

In Re The Topps Company Shareholders Litigation
(2007) Cons. C.A. No. 2786-VCS
Court of Chancery, State of Delaware
June 14, 2007

The court enjoined a shareholder vote on a proposed $416-million merger between The Topps Company and a group consisting of The Tornante Company LLC (headed by former Disney CEO Michael Eisner) and Madison Dearborn Partners, LLC on the basis that until further disclosure was made, shareholders would be prejudiced because these would lose the opportunity to make an informed decision and to accept another offer that they might find more attractive.

Vice Chancellor Strine, among other conclusions, stated that the misuse of a standstill agreement to prevent stockholders from obtaining material information related to a potentially superior bid runs contrary to the board's *Revlon* duties. Vice Chancellor Strine also confirmed that the failure by the board to fully disclose assurances given by a bidder of its intention to retain key personnel or to disclose the existence of an unfavourable valuation presentation could, in appropriate circumstances, be grounds to enjoin a shareholder vote until such disclosure is made.

Background

After a failed auction of its confectionary business, the management of Topps added certain dissident directors to the board in an effort to satisfy insurgent shareholders who threatened to defeat management nominees. An "Ad Hoc Committee" consisting of four board directors – two incumbent directors and two dissident directors – was formed to evaluate Topp's strategic direction. Both sides were ambivalent about a sale, but the dissident directors insisted that any sale should involve a public auction process.

Former Disney CEO Michael Eisner had for some time been expressing to Topps CEO Arthur Shorin an interest in taking Topps private. In addition to Eisner, two other potential buyers made overtures but Topps maintained that it was not for sale. After the two other bidders dropped out, Eisner was told by a key incumbent director that the incumbent directors would be amenable to a bid of $10 per share. Eisner proceeded with a $9.24 per share bid (a 5.7% premium over Topps's then-current trading price), which included the retention of existing management, including Shorin. The Ad Hoc Committee split down incumbent-dissident lines for and against the merger, respectively, as the dissidents wanted a public auction and refused to participate in the negotiations with Eisner.

An incumbent director negotiated a merger agreement with Eisner for a $9.75 per-share bid, which included the right for Topps to accept a superior proposal as well as a 40 day post-signing go-shop. Eisner exacted both a termination fee ranging from 3.0% during the go-shop period to 4.6% thereafter and the promise of no pre-signing auction. The board approved the merger agreement in a divided vote, with the incumbents favouring the merger and the dissidents dissenting. The Ad

Hoc Committee was so dysfunctional that it was replaced during the go-shop period by an executive committee of incumbent directors.

Before the board approved the merger agreement with Eisner, Topps's chief competitor, The Upper Deck Company ("Upper Deck"), expressed a willingness to make a bid. Upper Deck had indicated interest in a friendly deal on a consistent basis since 1999, and Shorin knew this. Topps signed the Eisner merger agreement without making any reaction to the Upper Deck bid. Once the merger was approved by the board (along incumbent-dissident lines, for and against, respectively), Topps' investment banker began the go-shop process, soliciting more than 100 potential strategic and financial bidders. Upper Deck emerged as the only serious bidder.

Upper Deck expressed a willingness to pay $10.75 per share in a friendly merger both during and after the go-shop period, subject to additional due diligence. During the go-shop period, the board voted against making a finding that the Upper Deck bid was likely to result in a superior proposal. After the end of the go-shop period, Upper Deck made another unsolicited offer, waiving its financing contingency, and which included a "hell or high water" promise to deal with antitrust issues and a reverse break-up fee of $12-million, the same that Eisner had exacted for himself. Once again, the incumbent directors refused to consider the Upper Deck bid as being a superior proposal, which Eisner would be required to match.

Topps publicly announced Upper Deck's bid, but did so in a form that did not accurately represent that expression of interest. Furthermore, Topps had required Upper Deck to sign a standstill agreement in which Upper Deck was prohibited from making public any information about its discussions with Topps or proceeding with a tender offer for Topps shares without permission from the Topps board (the "Standstill Agreement"). The Topps board refused Upper Deck's request for relief from its Standstill Agreement in order to make a tender offer and tell its side of events.

A group of shareholders and the Upper Deck moved for a preliminary injunction, alleging that the merger vote would be tainted by Topps' failure to disclose material facts about the process that led to the merger agreement with Eisner and about Upper Deck's offer.

Breach of Revlon Duties

In its analysis of whether the Topps board breached their *Revlon* duties, the Chancery Court found that the board was reasonable in recognizing that no pre-signing market check had occurred and to include a 40-day go-shop in the agreement, which permitted the board to continue discussions with any bidder that was deemed likely to make a superior proposal.

However, the Chancery Court held that Topps' misuse of the Standstill Agreement with Upper Deck was likely a breach of the board's fiduciary duties. While Vice Chancellor Strine recognized that parties often insist on a standstill as a deal protection, he also recognized that standstill agreements can also be used by a target to favour one bidder over another.

In this case, Topps reserved the right to waive the Standstill Agreement with Upper Deck if its fiduciary duties required it to do so. However, after Upper Deck asked that it be released from the Standstill Agreement in order to communicate with Topps' stockholders, Topps declined this request. The Chancery Court noted that this refusal not only deprived stockholders of the opportunity to accept a potentially more attractive offer, but it also kept them from knowing Upper Deck's version of events and prevented Upper Deck from starting the process of seeking antitrust clearance.

Materially Misleading Disclosure

The Chancery Court identified three material subject areas that were not found in the proxy disclosure prepared and sent out by the incumbent directors:

1. The Failure to Disclose Eisner's Assurances to Topps Management

The proxy statement should have disclosed that Eisner stated his proposal was "designed to retain substantially all of [Topps's] existing management and key employees" and that Eisner had continually reassured key Topps executives of his desire to keep them on. Omission of these facts creates a misleading impression that Topps managers were not given such assurances by Eisner.

2. The Failure to Disclose a Lehman Brothers' Valuation Presentation that Cast Doubt on Fairness

The proxy statement included two sets of financial projections and indicated that the DCF values were calculated on March 1, 2007, in connection with Lehman Brothers' ("Lehman") ultimate fairness presentation. The proxy suggests that one set was "very aggressive" and developed primarily as a "selling tool", with a value range of $10.31 to $12.57 per share, whereas the other set was prepared as a more conservative and "realistic" projection of what Topps could achieve, with a range of $8.76 to $10.16 per share. However, on January 25, 2007, Lehman had made a detailed presentation to the Topps board wherein they offered a conservative DCF range of $9.67 to $10.66 per share.

The Chancery Court found problematic the changes that Lehman had made between the assumptions underlying their January 25 models and the ultimate March 1 models that were included in the proxy statement. In the January 25 models, Lehman used a cost of capital basis between 11% and 12%, based on the then actual cost of capital of 11.6%. However, in the March 1 models, Lehman used a range of 11.5% to 13.5% in its analysis, despite the fact that the actual cost of capital remained 11.6%. Further, the March 1 presentation used a higher cost of capital for the aggressive model than it had on January 25.

In its submissions, Topps explained that Lehman would not base a fairness opinion on projections that had not been prepared by management. To prepare the January 25 models, Lehman used five years of projections, which were disclosed in the proxy statement. However, for the March 1 presentation, which accompanied the five year projection figures in the proxy statement, Lehman only used three years of projections. The Chancery Court found that this put even more weight on the terminal value calculation, and did not rationally achieve the objective Lehman had sought to attain.

The Chancery Court noted that terminal value calculation "embeds hugely important subjective judgments about the corporation's future, including its likely future cash flows." Notably, Lehman reduced its range of exit multiples in the truncated March 1 models: for the January 25 models, the exit multiple range used was 9.0 to 10.0, while in the March 1 models it was 8.5 to 10.0. Vice Chancellor Strine noted that:

As anyone who performs valuations knows, raising discount rates and lowering terminal multiples drives down the resulting range… In this case, one can accept the decrease that came from management changes that made the projections more realistic based on more current information; indeed, the very modest nature of those changes – reducing expected compound annual sales growth in the [conservative case] from 5.8% to 5.6%, and in the [aggressive case] from 9.3% to 9.0% – inspires some confidence. What is not at all clear is why these modest changes were accompanied by major shifts in Lehman's analytical approach.

The Chancery Court concluded that the defendants had not made "any confidence-inspiring explanations for Lehman's analytical changes." There was no evidence that the January 25 DCF analysis was no longer reliable but that it had "cast the price Eisner was offering to pay in a quite different light than that which Lehman performed on March 1." In the result, the Chancery Court held that the proxy statement was materially misleading for failing to discuss the advice given to the board about the January 25 valuation.

<u>3. Alleged Omissions and Material Misstatements of Fact Related to Upper Deck's Credibility as a Buyer</u>

The Chancery Court also made several findings related to Topps's failure to disclose certain details about its dealings with Upper Deck:

1. After preliminary discussions with Eisner in 2006, Topps received two unsolicited offers. In response, Topps CEO Shorin wrote a letter informing the market that Topps was not interested in a "quick fix" sale and such an offer would not be considered by the board. The plaintiffs contend that although Topps was apparently secretly willing to entertain unsolicited bids, Shorin discouraged bids by making that statement. This chronology of events was missing from the proxy statement. The Chancery Court found that, under Delaware law, "when directors undertake to tell a story they must do it in a non-misleading manner."
2. The Chancery Court also found that the failure to disclose that Upper Deck offered a $12-million reverse break-up fee, the same remedy as Eisner had offered, was materially misleading.

3. Although Topps disclosed that Upper Deck's bid was rejected because it failed to provide a firm debt financing commitment, the proxy statement failed to disclose that Upper Deck's bid was not subject to a financing contingency. Despite the fact that Topps had decried the contingent nature of a "highly confident" bank financing letter, it did not explain that many of the conditions in the letter related to the bank's desire to examine information that Topps was refusing to provide to either Upper Deck or its bankers (which had pledged not to disclose any information it obtained to Upper Deck).
4. While the proxy statement disclosed Topps's concerns related to antitrust obstacles that would be associated with a merger agreement with Upper Deck and Upper Deck's apparent "unwillingness to sufficiently assume the risk associated with a failure to obtain the necessary antitrust approval," the proxy statement did not disclose the revised Upper Deck bid that contained a strong "hell or high water" antitrust provision.
5. Finally, Topps failed to disclose the terms of the standstill agreement that prevented Upper Deck from not only making a tender offer to Topps stockholders but also from even responding to the public statements made by Topps about Upper Deck's bid.

Vice Chancellor Strine issued the injunction having found that there was no reasonable basis for permitting the Topps board to deny its shareholders the chance to consider Upper Deck's deal. He declined to permit Topps to avoid the injunction on the premise that shareholders would be unable, after being provided with full information, to rationally decide for themselves between two competing, non-coercive offers. Therefore, the vote on Eisner's merger agreement was enjoined until Topps issued corrective disclosure.

In Re Lear Corporation Shareholder Litigation
(2007) Cons. C.A. No. 2728-VCS
Court of Chancery, State of Delaware
June 15, 2007

The Court of Chancery granted a limited injunction delaying a shareholder vote until additional proxy information was disclosed, further illustrating its willingness to intervene in a sale process when shareholders are

not provided with information necessary to make informed decisions, especially where the failure to provide such information can be attributed to a lack of board and special committee oversight during the negotiating process.

The Chancery Court addressed: (1) disclosure of material facts relating to Lear Corporation's ("Lear") CEO, who had potential personal economic motivations behind a proposed acquisition by a private equity fund controlled by Carl Icahn ("Ichan"), and (2) the fiduciary obligations of a board of directors to act reasonably to obtain the highest price available.

Background

Icahn first proposed the idea of a going-private transaction to Lear CEO Robert E. Rossiter ("Rossiter") at a meeting in early 2007. The meeting occurred just one month after Rossiter had sought permission from the board to accelerate his own benefits but decided not to for fear of public criticism.

Over a week after the meeting between Rossiter and Icahn, Lear formed a Special Committee to expeditiously evaluate and negotiate proposals from Icahn and to consider alternatives. However, the Special Committee did not become directly involved in due diligence or merger negotiations, allowing Rossiter to lead the negotiations as it did not believe there was a significant conflict for him to do so.

In the following weeks, the parties obtained revisions to financial projections initially prepared by JP Morgan Securities Inc. ("JP Morgan") during a broad restructuring effort by Lear in the previous two years. These new projections were more pessimistic than those initially prepared. Price negotiations began between Icahn and Rossiter after receiving the new projections, but neither JP Morgan nor any Special Committee member participated in these talks.

Rossiter delivered the final price offered by Icahn to the Special Committee. After some debate, the board concluded that a formal sale process or auction would be too disruptive to business and customer relations and, more importantly, that Icahn might pull out of discussions, causing the price of Lear stock to fall. The Lear board agreed on a go-shop structure and negotiated an improvement of the Icahn offer to include a tiered termination fee and a voting agreement.

Icahn's American Real Estate Partners, LP ("AREP") and Lear signed a merger agreement for $36 per share, which included a $250-million reverse termination fee, a $79.5-million break-up fee (plus reimbursement of up to $20-million in expenses) upon termination by Lear and a 45-day go-shop period. JP Morgan issued a fairness opinion in favour of the Icahn offer based on various DCF models they ran.

Though previous suitors and other potential buyers were solicited by JP Morgan, none made a preliminary bid and Lear received no unsolicited bids.

The Lear Board's Breach of Fiduciary Duty

The plaintiffs' alleged that the Lear board of directors breached its fiduciary obligations because it failed to make adequate disclosure to the shareholders, and failed to act reasonably to secure the highest price available.

The plaintiffs first claimed that the proxy statement failed to disclose one of several drafts of a DCF model concerning the value of Lear's future cash flows prepared by JP Morgan. Although the final model was presented to the board in JP Morgan's final fairness presentation, the plaintiffs argued that the draft was material.

The Chancery Court noted that Lear's proxy statement disclosed a wide range of values, including one based on a more optimistic assessment from projections made during its restructuring efforts in the previous year. The Chancery Court concluded that the plaintiffs failed to demonstrate a reasonable likelihood of success on this claim because they did not develop any evidence in discovery that suggested this model was "embraced as reliable by either the senior bankers in charge of the deal or by Lear management."

The plaintiffs also alleged that the Lear board failed to disclose certain aspects of the pre-signing and post-signing market checks, namely the supposed predisposition of Rossiter towards financial buyers like Icahn rather than a sale to a strategic acquirer. The Chancery Court held that this claim was without merit, as a "request for self-flagellation does not suffice as a disclosure claim". The court noted that the proxy statement made clear that Lear did not seek a price change after the company had publicly disclosed Icahn's $36 bid precisely because Icahn

had said he would go no higher and was unwilling to negotiate that term. Vice Chancellor Strine held that the proxy statement fairly disclosed that Lear did not conduct any meaningful pre-signing market check and that it had sought to lengthen the post-signing shopping period and strengthen its position by getting Icahn to promise to vote his shares in favour of a Superior Proposal.

Finally, the plaintiffs complained that there had been limited disclosure that Icahn had negotiated with Rossiter and two other key Lear managers to continue their employment. Rossiter had also negotiated a short-term schedule of payouts for his retirement benefits, increased salary and bonuses as well as options if the resulting entity performed well after the merger. Rossiter had an interest in accelerating his retirement benefits in order to liquidate the net worth he had tied up in Lear and out of fear that he would rank as an unsecured creditor in the event of an industry downtown and subsequent Lear bankruptcy. Prior to Ichan's offer, Rossiter had refused the board's proposal to allow him to gradually withdraw retirement benefits because of the potential negative publicity and reaction from institutional investors. These matters were not disclosed in the proxy circular.

Vice Chancellor Strine believed these events to be material, given that a going private transaction would give Rossiter, the lead negotiator tasked with obtaining the best price for stockholders, an important economic motivation for getting *a* deal done, not necessarily the *best* deal done. The Chancery Court noted that although Rossiter did not act inappropriately, the shareholders deserved to know that Rossiter had "material economic motivations that differed from their own that could have influenced his negotiations with Icahn" and that the board had an obligation to make this disclosure.

The Court also considered arguments that the board failed to properly oversee Rossiter or to ensure that he obtained the highest price reasonably available. Specifically, the plaintiffs alleged that the negotiation of the merger was tainted by the Special Committee's decision to give the task of negotiating the best price and most beneficial terms solely to Rossiter, despite his personal interest in achieve a deal over the best deal.

The Chancery Court commented that it would have been "preferable" for the Special Committee to have had its chairman or its lead banker

participate in the Icahn negotiations, as this would provide more assurance that Rossiter would take a tough line and avoid inappropriate discussions that would taint the process. Nonetheless, despite the "less-than-ideal" approach to price negotiations, Vice Chancellor Strine declined to find that the Lear board acted unreasonably in refusing to demand a full auction before signing. While some shareholders claimed that Lear was actually worth $60 per share, he noted these shareholders passed on the chance to buy additional stock at $23 per share just months before the merger agreement with Icahn.

Finally, the Chancery Court refused to accept the plaintiffs' argument that the increased termination fee payable for a compliant bid following the go-shop period combined with Icahn's contractual match right were bid-chilling. Although the plaintiffs referenced the 3.5% equity value of the termination fee, the Chancery Court found the 2.4% enterprise value metric to be the more important measure as most acquisitions require the buyer to pay for the company's equity *and* refinance all of its debt. Regardless of which valuation was considered, Vice Chancellor Strine held that neither would deter a serious rival. Despite the plaintiffs' claim that Icahn should have received a lower fee because he would profit from a topping bid due to his equity holdings, the agreement of the board to the 3.5% fee (2.8% during the go-shop) was not unreasonable.

Despite varying valuations submitted by the plaintiffs' valuator, the higher of which was admitted to being formulated based on erroneous or inconsistent discount rates, the Chancery Court held that when traditional measures of valuation such as the DCF were considered and that the $36 price had been and was still at that time being subjected to a real world market check, the $36 per share bid price appeared to be a reasonable one.

The Chancery Court also distinguished this case from *In re Netsmart Technologies*, in which the court noted the limited auction process was deficient, on the basis that Netsmart was a microcap company with limited trading in its shares and one analyst covering it, whereas Lear was one of the largest corporations in the United States with deep analyst coverage. In essence, the distinction was that no one had to discover Lear; its elimination of its poison pill years prior to the Icahn bid had signalled its openness to bids and even after Icahn's bid, over 40 strategic and financial bidders

were invited to obtain due diligence in order to formulate a topping bid, but none materialized.

United Rentals, Inc. v. RAM Holdings Inc.
(2007), C.A. No. 3360-CC
Court of Chancery, State of Delaware
December 21, 2007

United Rentals, Inc. ("URI") recently lost a bid to force a $4-billion takeover by Cerberus Capital Management LP ("CCM") when a judge ruled that the merger agreement allowed the buyer to pull its offer. In coming to its decision, the court was required to look past the ambiguity in the merger agreement to find the "subjective understanding" of the parties. Although some in the media have discussed this case in the context of Material Adverse Change clauses, the dispute between URI and Cerberus can be understood as a "good, old-fashioned contract case prompted by buyer's remorse." Most importantly, Chancellor Chandler's decision should serve as a reminder to focus closely on the wording of agreements and provide pause to those willing to forsake clarity in the agreement language in order to reach a compromise.

Facts

URI is a publicly traded company listed on the New York Stock exchange and the largest equipment rental company in the world based on its revenue. On or about May 18, 2007, URI offered itself up for sale through a draft merger agreement sent to potential buyers, including the investment fund CCM (a management company that, together with other affiliated entities, manages investment funds, including Cerberus Partners L.P.).

RAM Holding and RAM Acquisition (collectively "RAM"), shell entities controlled by funds and accounts affiliated with CCM, were formed solely to effectuate the transactions contemplated under the Merger Agreement which was executed on July 22, 2007. RAM agreed to purchase all of the common shares of URI for $34.50 per share in cash, for a total transaction value of approximately $7 billion (which included the repayment or refinance of URI's existing debt). To ensure that there would be some level of financial backing for RAM's obligations under the Merger Agreement, URI entered into the Limited Guarantee with Cerberus Partners L.P. (something considered "market practice" in LBO transactions sponsored by private equity firms). The Limited Guarantee provided that Cerberus Partners L.P.

would guarantee payment, up to a maximum amount of $100 million plus certain solicitation expenses, of the enumerated payment obligations of RAM under the Merger Agreement.

On November 14, 2007, RAM Holdings notified URI it would not proceed with the acquisition on the terms in the Merger Agreement, but was prepared to discuss revised terms. URI initially maintained that RAM's actions were directed at putting pressure on URI's board of directors to renegotiate a price below $34.50 per share. (Indeed, on the evening of November 14 – the same day that RAM sent its letter – a senior executive of RAM contacted URI's investment banker to offer a substantially reduced price.) URI promptly rejected this "offer" and, on November 19, 2007, filed a lawsuit seeking specific performance of the Merger Agreement.

At issue were two provisions in the Merger Agreement and their interpretation. Section 9.10 addressed the right of URI to seek specific performance to enforce the Merger Agreement. This section, however, also stated that it was "subject in all respects to Section 8.2(e) hereof, which Section shall govern the rights and obligations of the parties… under the circumstances provided therein". Section 8.2(e) described a $100 million Parent Termination fee payable to URI as the "sole and exclusive" remedy against RAM under the Agreement when there has been a termination of the Merger Agreement by URI and precluded equitable relief. Essentially, the Merger Agreement purported to provide *and* preclude the remedy of specific performance.

Chancellor Chandler found that the Merger Agreement was ambiguous. In such a case, summary judgment was inappropriate because the court was presented with a genuine issue of material fact: what was the common understanding of the parties with respect to the remedies in the Merger Agreement? The court was required to consider extrinsic evidence during a trial to ascertain the meaning of the Merger Agreement, including "overt statements and acts of the parties, the business context, prior dealings between the parties, [and] business custom and usage in the industry."

Over the two-day trial, the court heard extensive testimony. URI contended that it communicated to RAM throughout the course of negotiation that it wanted to restrict its ability to unilaterally refuse to close the transaction. URI also claimed it was apparent that it required "deal certainty" so that RAM simply could not refuse to close for reasons relating to its debt financing.

In contrast, RAM argued that its principal attorney contract negotiator consistently communicated that Cerberus had a $100 million walkway right and that URI knowingly relinquished its right to specific performance under the Merger Agreement.

The court found that parties began their negotiations very far apart, and had circulated numerous drafts with "heavy-handed" mark-ups of the other side's contributions. Early conversations led to no agreement, and URI simply ignored many of the proposed changes that RAM initially made. Although RAM ultimately succeeded in striking many of the provisions entitling URI to specific performance and did modify section 8.2(e) to try to limit the availability of equitable relief, section 9.10 in the final agreement continued to speak of the URI's right to specific performance. Testimony also revealed that communications between the parties routinely skirted the issue of equitable relief and only addressed it tangentially or implicitly.

URI, which sought to specifically enforce the Merger Agreement, had to demonstrate that the common understanding of the parties was that the contract allowed for the remedy of specific performance and that URI was entitled to such a remedy. The court, however, concluded that the extrinsic evidence was not clear enough to conclude that there was a single, shared understanding with respect to the availability of specific performance under the Merger Agreement.

In cases like this, where the extrinsic evidence did not lead to a single, commonly held understanding of a contract's meaning, the court could apply the "forthright negotiator principle", in which it considers whether the subjective understanding of one party has been objectively manifested and is known or should be known by the other party. In applying this principle, Chancellor Chandler made two additional findings. With respect to RAM, although it could have easily avoided this entire dispute by striking section 9.10(b) from the contract, the court found that its attorney did communicate to URI his understanding that the Agreement precluded any specific performance rights. With respect to URI, he found that even if it had believed the contract preserved a right to specific performance, its attorney categorically failed to communicate that understanding to the defendants during the latter part of the negotiations. In effect, even if URI did believe it had a right to specific performance, RAM did not know and had no reason to know of URI's understanding of the Merger Agreement. Consequently, Chancellor Chandler concluded that URI had failed to meet

its burden and that the Merger Agreement did not afford it the remedy of specific performance.

The evidence presented at trial demonstrated a deeply flawed negotiation in which both sides failed to clearly and consistently communicate their client's positions. If Cerberus had simply deleted section 9.10(b), the contract would not have been ambiguous. The law of contracts, however, does not require parties to choose optimally clear language and parties often "riddle their agreements with a certain amount of ambiguity" in order to reach a compromise. This case highlights the dangers of such an approach and should serve as a warning to parties in similar negotiations. Those unwilling to provide clarity in the wording of their agreements might suddenly find their "subjective understandings" being scrutinized by the courts in an effort to discern intent.

Certain Regulatory Developments

III Certain Canadian Regulatory Developments

HARMONIZED TAKE-OVER AND ISSUER BID REGIME

The Canadian Securities Administrators ("CSA") are implementing new rules on take-over and issuer bids which harmonize the treatment of bids in all jurisdictions of Canada. All Canadian jurisdictions, other than Ontario, have or will shortly adopt Multilateral Instrument 62-104 *Take-over Bids and Issuer Bids*. In Ontario the corresponding regime was implemented by the amendment of Part XX of the *Securities Act* (Ontario) and the adoption of Ontario Securities Commission Rule 62-504 *Take-over Bids and Issuer Bids* on February 1, 2008. All jurisdictions have or will shortly adopt National Policy 62-203 *Take-Over Bids and Issuer Bids*. The result of these actions is a substantially harmonized take-over bid regime across Canada which is referred to below as the "Bid Regime". The Bid Regime also introduces some changes to the laws regulating bids. The key changes are:

Acting Jointly or in Concert: The concept of "acting jointly or in concert" or being a "joint actor" with the bidder has been changed from the prior law. This is an important concept in bid regulation as it effects, among other things, when early warning reporting of security holdings must be made, when the take-over or issuer bid threshold has been reached and what disclosure needs to be made. While it is a question of fact as to when another party is acting jointly or in concert with the bidder, prior to the introduction of the Bid Regime, certain persons, including affiliates, associates and persons who had an "agreement or commitment or understanding" with the bidder to acquire securities, were presumed to be joint actors. This presumption was rebuttable. The Bid Regime now deems such persons, other than associates, to be joint actors. Associates of the bidder will continue to be presumed and not deemed to be acting jointly or in concert.

Collateral Benefits: A fundamental concept of takeover bid treatment is the fair and equal treatment of all securityholders. As a result, there is a general prohibition against a bidder or a joint actor of the bidder from entering into any collateral agreement or understanding with any securityholder that has the effect of providing greater value than that offered to any other securityholder. Prior to the implementation of the Bid Regime, there was no exemption from this general prohibition despite the fact that it was and is common practice to offer employment agreements to retain personnel of the target company following a bid. The Bid Regime now provides an exemption from this general prohibition for employment arrangements and benefits, provided certain conditions are met.

Variation of Terms of Bid: The Bid Regime provides guidance on how certain variations made during the course of a bid will be treated by securities regulators. The guidance indicates that securities regulators may exercise their public jurisdiction to intervene in a bid where the consideration offered has been lowered or the form of consideration has changed, the percentage of securities sought to be acquired has been lowered or new conditions of the bid have been added.

Filing of Material Bid Documentation: The Bid Regime introduces a new requirement whereby both bidders and targets will be required to file copies of all documents relating to the bid or which could affect control of the target (e.g., lock-up and support agreements). This will increase the transparency of disclosure regarding agreements that affect control of the target.

NEW RULE ON RELATED PARTY TRANSACTIONS INTRODUCED IN ONTARIO AND QUEBEC

Contemporaneously with the enactment of the new Bid Regime, the Autorité du Marché Financiers and the Ontario Securities Commission introduced Multilateral Instrument 61-101 *Protection of Minority Securityholders in Special Transactions* (the “Related Party Instrument”). The Related Party Instrument replaces Regulation Q-27 *Respecting Protection of Minority Securityholders in the Course of Certain Transactions* in Quebec and Rule 61-501 – *Insider Bids, Issuer Bids, Business Combinations and Related Party Transactions* in Ontario. The Related Party Instrument harmonizes the requirements regarding required disclosure, independent valuation and majority of minority securityholder approval in the case of an insider bid, issuer bid, business combination and related party transaction. Most of

the changes introduced in the Related Party Instrument are to conform the Related Party Instrument with the new Bid Regime. However, the Related Party Instrument has extended certain exemptions from the requirement to obtain an independent valuation of certain transactions. The exemption from acquiring a formal valuation on a business combination and related party transaction that is available only where securities are not listed on the TSX or a market outside of Canada has been amended to allow issuers to rely on the exemption in the event their securities are listed on the Alternative Investment Market of the London Stock Exchange. In addition, the valuation exemption available on a statutory amalgamation or equivalent transaction that has no adverse effect on the issuer or the minority of an issuer has been extended to cover both related party transactions and business combinations.

NEW RULES ON FORWARD-LOOKING INFORMATION

Effective December 31, 2007, the CSA implemented new requirements regarding the disclosure of forward-looking information, including future-oriented financial information ("FOFI") and financial outlooks such as earnings guidance. The purpose of these amendments is to improve the quality and consistency of forward-looking information and the new rules apply to all forward-looking information (other than oral statements). These requirements for forward-looking information are contained in National Instrument 51-102 – *Continuous Disclosure* (the "Continuous Disclosure Instrument"). The Continuous Disclosure Instrument substantially maintains the requirements for FOFI currently contained in National Policy 48 – *Future Oriented Financial Information* and extends their applicability to other types of future-oriented information, such as earnings guidance and other financial outlooks.

Key Definitions: There are three key definitions that are relevant to the new requirements. "Forward-looking information" is disclosure regarding possible events, conditions or results of operations that is based on assumptions about future economic conditions and courses of action and includes future-oriented financial information with respect to prospective results of operations, financial position or cash flows that is presented as a forecast or a projection. "Financial outlook" means "forward-looking information about prospective results of operations, financial position or cash flows that is based on assumptions about future economic conditions and courses of action and that is not presented in the format of a historical

balance sheet, income statement or cash flow statement". Examples of financial outlooks include expected revenues, net income, earnings per share and R&D spending. A financial outlook relating to earnings is commonly referred to as "earnings guidance". The term "future-oriented financial information" or "FOFI" is forward-looking information about prospective results of operations, financial position and/or cash flows, based on assumptions about future economic conditions and courses of action, and presented in the format of a historical balance sheet, income statement or cash flow statement.

Preparation of Forward-looking Information: Reporting issuers must have a "reasonable basis" for any forward-looking information they disclose. When interpreting "reasonable basis", issuers should consider both the reasonableness of the assumptions underlying the information and the process followed in preparing and reviewing such information.

Required Disclosure Accompanying Material Forward-looking Information: Material forward-looking information must include disclosure that identifies the information as forward-looking information; cautions users that actual results may vary and identifies material risk factors that could cause actual results to differ materially from the forward-looking information; states the material factors or assumptions used to develop the information; and describes the issuer's policy for updating the information.

Preparation of FOFI and Financial Outlooks and Accompanying Disclosure: In preparing FOFI or a financial outlook, a reporting issuer is required to:

- use assumptions that are reasonable in the circumstances;
- limit the period covered by the FOFI or financial outlook to one for which such information can be reasonably estimated (in many cases the period will not extend beyond the end of the issuer's next fiscal year);
- use accounting policies that the issuer expects to use in preparing its historical financial statements for such period;
- disclose the date on which management approved the FOFI or financial outlook if this information is undated; and
- explain the purpose for the FOFI or financial outlook and caution that such information may not be appropriate for other purposes.

Updating Requirements: Reporting issuers must discuss in their MD&A or press release disclosure events and circumstances that occurred during the MD&A period that are reasonably likely to cause actual results to differ materially from previously disclosed material forward-looking information for a period that is not yet complete. Issuers are also required to discuss the expected differences.

Comparison of FOFI and Financial Outlooks to Actual Results: Reporting issuers must disclose in their MD&A material differences between their actual results and any previously disclosed FOFI or financial outlooks for the period to which the MD&A relates. The disclosure should cover differences for material individual items included in the FOFI or financial outlook, including assumptions.

Withdrawal of Forward-Looking Information: Reporting issuers must disclose in their MD&A if a decision was made during the MD&A period to withdraw previously disclosed material forward-looking information and discuss the events and circumstances that led to such decision, including any underlying assumptions that are no longer valid.

No Audit Report on FOFI in an Offering Document: The amendments remove the previously existing requirement that an auditor's report must accompany any FOFI included in a prospectus or other offering document.

Exemption for oil and gas and mining issuers: The requirements for FOFI and financial outlooks and disclosure in MD&A regarding the updating, comparison to actual results and withdrawal do not apply to disclosure that is subject to the requirements of National Instrument 51-101 – *Standards of Disclosure for Oil and Gas Activities* or National Instrument 43-101 – *Standards of Disclosure for Mineral Projects* or the conditions of any exemption from those instruments.

Other Disclosure Documents: Corresponding amendments have been made to other instruments to ensure that forward-looking information included in an offering document (prospectus, rights offering circular or offering memorandum) comply with the preparation and disclosure requirements set out in the Continuous Disclosure Instrument.

PROPOSED NEW RULES ON EXECUTIVE COMPENSATION DISCLOSURE

On February 22, 2008, the CSA published for public comment proposed amendments to the Continuous Disclosure Instrument (the "2008 Proposals"). The 2008 Proposals introduce new rules regarding the disclosure of executive compensation which are intended to improve the quality of such disclosure and provide the market with comprehensive information on the value of the total compensation payable to an issuer's key executive officers and how such compensation is determined. In formulating the 2008 Proposals, the CSA considered the executive compensation disclosure rules introduced by the U.S. Securities and Exchange Commission ("SEC") in 2006. The prior publication of executive compensation disclosure rules by the CSA in March 2007 (the "2007 Proposals") generated significant public comment and the 2008 Proposals respond to certain of the concerns raised. The proposed effective date of the 2008 Proposals is December 31, 2008.

Key requirements of the 2008 Proposals include:

- required disclosure in an issuer's annual meeting circular of a total compensation figure (direct and indirect) for each named executive officer ("NEO") of the issuer for the last three fiscal years;
- a discussion and analysis of the executive compensation provided to NEOs over the last fiscal year. This disclosure is intended to provide a narrative overview of compensation. The disclosure should be "non-boiler plate" and should set out the objectives of the compensation program, what the compensation program is designed to reward, each element of compensation, why the issuer chooses to pay each element, how the issuer determines the amount (and, where applicable, the formula) for each element, and how each element and the issuer's decision regarding that element fit into the overall compensation objectives of the issuer;
- a comparison of the trend in securityholder return to the issuer's executive compensation over the same period;
- disclosure of grant date fair value of all plan-based compensation;
- disclosure of the value of defined benefit pension plans. The 2008 Proposals depart from the 2007 Proposals which required disclosure of the change in pension value over the last year;

- enhanced disclosure of potential termination payments to NEOs in the event of retirement, change of control, resignation or termination; and
- enhanced disclosure of directors' compensation.

INTERNAL CONTROLS CERTIFICATION

On April 18, 2008, the CSA published for public comment a proposed new national instrument (the "Proposed Instrument") which if enacted would repeal and replace Multilateral Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*. The Proposed Instrument will expand the certification and disclosure requirements with respect to internal controls over financial reporting ("ICFR") currently in place. If enacted the proposed rules will apply in respect of financial periods ending on or after December 15, 2008. The Proposed Instrument and its companion policy are open for public comment until June 17, 2008.

The Proposed Instrument will require non-venture reporting issuers, other than investment funds, to establish and maintain disclosure controls and procedures ("DC&P") and ICFR and to use a control framework to design its ICFR. The companion policy provides guidance as to suitable frameworks for ICFR and refers to the COCO Framework published by the Canadian Institute of Chartered Accountants, the COSO Framework published by the Committee of Sponsoring Organizations of the Treadway Commission and the Turnbull Guidance published by the Institute of Chartered Accountants in England and Wales.

In addition to the current certification which CEOs and unders the proposed instrument CFOs of issuers are required to make the CEO and CFO of a non-venture reporting issuer will be required to certify the control framework used to design the issuer's ICFR and that (i) they have evaluated or caused to be evaluated on an annual basis the effectiveness of the issuer's ICFR at its financial year end, (ii) the issuer has disclosed in its interim or annual MD&A any material weakness relating to the design of its ICFR and included a description of such weakness, the impact of such weakness on the issuer's financial reporting and its ICFR and its current plans, if any, for remediating such weakness, and (iii) on an annual basis, they have disclosed to the issuer, its auditor, and board of directors or audit committee, any fraud involving management or employees who have a significant role in ICFR. The proposed certification will allow certifying officers to limit the scope of design of DC&P and ICFR to exclude controls,

policies and procedures of proportionally consolidated entities, variable interest entities or any business that the issuer acquired not more than 365 days before the issuer's financial year end. A material weakness is defined to mean a deficiency, or combination of deficiencies, in ICFR such that there is a reasonable possibility that a material misstatement of the issuer's annual or interim financial statements will not be prevented or detected on a timely basis. This definition has been harmonized with the US definition of material weakness under Section 404 of the *Sarbanes Oxley Act*.

Unlike the US, issuers will not be required to obtain from their external auditors an internal control audit opinion concerning management's assessment of the effectiveness of ICFR. The companion policy to the Proposed Instrument confirms that using a top down, risk based approach to ICFR and DC&P certification is appropriate. In addition, the companion policy provides guidance on how the use of third parties such as service organizations and specialists affects the design and evaluation process.

Issuers who comply with the US rules regarding certification of ICFR will be exempt from the Proposed Instrument provided the issuer files the US certification and ICFR attestation report on management's assessment of ICFR with the Canadian securities regulator.

The Proposed Instrument would not require venture issuers to certify as to the design and effectiveness of ICFR or the establishment, maintenance and design of DC&P as other reporting issuers will be required to do. Venture issuers will be, therefore, required to file in respect of financial periods ending on or after December 15, 2008, a basic form of certification that provides that the CEO and CFO have reviewed the annual filings and that such filings fairly represent the results of operations and cash flow of the issuer and that they do not contain any misrepresentation. A statement that the certificate does not provide any certification as to ICFR or DC&P would also need to be made. The treatment of venture issuers under the Proposed Instrument reflects exemptive relief currently in place for such issues.

SECONDARY MARKET LIABILITY IN FORCE IN QUEBEC AND OTHER JURISDICTIONS

On November 9, 2007, *An Act to amend the Securities Act* (Quebec) and other legislative provisions (the "Quebec Act") came into force. The Quebec Act introduces a civil liability remedy for secondary market disclosure

in Quebec similar to provisions that have been in force in Ontario since December 31, 2005. A detailed description of the Ontario regime was contained in the April 2005 edition of the Valuation Law Review.

As in Ontario, the Quebec Act makes it easier for an investor to bring an action for damages if an issuer releases documents or statements containing a misrepresentation or fails to disclose a material change. An action can be brought against the issuer, its officers, its directors, influential persons or experts. The investor does not have to prove that he relied on a document or oral public statement containing a misrepresentation or on the issuer having complied with its timely disclosure obligations and he does not have the burden of proving damages.

As in Ontario, several defences are available under the Quebec Act. The defendant may defeat the action by proving that the plaintiff knew about the misrepresentation or the undisclosed material change. The defendant may also claim that he conducted a reasonable investigation to ensure that the document or public oral statement did not contain a misrepresentation or that no failure to make timely disclosure would occur. As is the case under Ontario law, other defences are available to a defendant other than the issuer if the alleged violation occurred without such defendant's knowledge or consent. The Quebec Act also provides a defence for an expert who can prove that his or her consent to the use of his or her report, statement or opinion had been withdrawn in writing before the document was released or the public oral statement was made. In the case of a document that is not required to be filed with the Autorité des Marchés Fiananciers, the defendant may defeat an action by proving that he did not know and had no reasonable grounds to believe that the document would be released.

The assessment of damages and apportionment of liability are also similar to the Ontario legislation. There is no limit on the damages that may be awarded if the misrepresentation or the failure to make timely disclosure was made knowingly. In other cases, limitations on damages are provided. Issuers and influential persons (other than individuals) will have their liability limited to the greater of 5% of their market capitalization and $1 million. The liability of a natural person, other than an expert, and that of directors and officers will be limited to the greater of $25,000 or 50% of the aggregate compensation (including all deferred compensation) received during the 12-month period preceding the date of the misrepresentation

or omission. The liability of an expert will be limited to the greater of $1 million and the revenue that the expert and the expert's affiliates earned from the issuer and its affiliates during the 12-month period preceding the time the misrepresentation was made.

Currently all provinces in Canada other than British Columbia have legislation in effect which provides for secondary market liability. British Columbia has introduced such legislation but it is not yet proclaimed in force.

BUSINESS CORPORATIONS ACT (ONTARIO) IS AMENDED

Amendments to modernize the *Business Corporations Act* (Ontario) (the "OBCA") to bring it in line with the *Canada Business Corporations Act* (the "CBCA") took effect August 1, 2007. The principle changes made to the OBCA were:

- The director residency requirement that previously required a majority of resident Canadian directors of a corporation subject to the OBCA was reduced to require that only 25% of directors must be resident Canadians. Where a company has less than four directors, at least one must be Canadian. In addition, there is no longer a requirement that a majority of the members of the committee of a board of directors be resident Canadians. This provides greater flexibility for Canadian subsidiaries of foreign corporations.
- The director's indemnification provisions have been expanded to allow indemnification of a person acting on a corporation's behalf in a managerial capacity in a non-corporate entity such as a joint venture.
- Like the CBCA, the OBCA now provides that a corporation may advance costs of a defence to directors, officers and other indemnified parties which funds need only be repaid if there is a breach of a fiduciary duty. No indemnity will be allowable in a criminal or administrative proceeding unless the indemnified person believed his or her conduct was lawful.
- Directors who are in a position of having a conflict of interest, in addition to being prohibited from voting as a result of such conflict of interest, are no longer permitted to attend any portion of a directors' meeting at which a matter in respect of which they have a conflict is discussed, except in certain limited circumstances.
- The amendments clarify that a director's and officer's duty of care is

owed to the corporation. This clarification was made in light of the Supreme Court of Canada's decision in *People's Department Stores v. Wise* which suggested a duty of care may be owed to others in addition to the corporation.

- The director's due diligence and reliance defence has been introduced and directors will be entitled to a defence based on the fact that they conducted reasonable due diligence or that they relied on financial statements and other reports.
- The rules relating to proxy solicitation have conformed the OBCA with the CBCA and provide that beneficial holders will be allowed to bring shareholder proposals in addition to registered holders. In addition to registered holders, expanded exemptions from preparing a dissident circular are also available.
- The provisions relating to disclosure of material financial assistance have been repealed.

PROPOSED TSX AMENDMENTS REGARDING SHARE EXCHANGE ACQUISITIONS

In October 2007, the Toronto Stock Exchange (the "TSX") released a notice requesting the public to comment on whether it should introduce amendments to the TSX Company Manual which would require the approval by securityholders of TSX-listed issuers of acquisitions of public companies made by such issuers. The TSX is considering requiring this approval where the securities of the TSX-listed acquiror being issued as consideration for the purchase exceed 25% or possibly some higher or lower percentage of the listed acquirors outstanding securities. The TSX Company Manual does not currently require approval by securityholders of a TSX-listed acquiror where the target company is a reporting issuer with 50 or more securityholders exclusive of insiders and employees. The request for public comment includes a request for comments as to whether a requirement will discourage or make acquisitions more difficult to complete and whether there should be an exemption retained for smaller issuers. The request notes that other exchanges do require securityholder approval in such circumstances. The public comment period ended in December of 2007 and no proposed changes to the TSX Company Manual have yet been published.

IV. Certain U.S. Regulatory Developments

SEC APPROVES NEW NASD RULE ON FAIRNESS OPINIONS

Effective December 8, 2007, the SEC approved the National Association of Securities Dealers Rule 2290 (the "NASD Rule") requiring National Association of Securities Dealers ("NASD") members to disclose potential conflicts of interest in rendering fairness opinions in change of control transactions.

Pursuant to the NASD Rule, a NASD member is required to disclose the following in its fairness opinion to the board of directors of an issuer if the member knows or has reason to know that the fairness opinion will be provided to the issuer's public shareholders:

(1) whether the NASD member has acted as a financial advisor with respect to the transaction for which the fairness opinion relates;

(2) whether the NASD member will receive compensation contingent upon the successful completion of the transaction for (a) the member serving as a financial advisor in respect of the transaction, (b) issuing its fairness opinion, or (c) any other reason;

(3) any material relationship that the NASD member has had during the past two years or is contemplated or will have with any party to the transaction and whether any compensation was received or is intended to be received as a result of such material relationship;

(4) the information provided to the NASD member by the company requesting the fairness opinion that formed a substantial basis for the fairness opinion and whether such information has been independently verified by the NASD member; and

(5) whether or not the fairness opinion was approved or issued by a fairness committee of the NASD member.

The NASD Rule also sets out procedural guidelines that NASD members are required to implement which are intended to identify potential conflicts of interest that may arise when a NASD member is rendering a fairness opinion. For example, a NASD member is required to have written procedures for approval of a fairness opinion, including the types of transactions and circumstances in which an NASD member will use a fairness committee to approve or issue a fairness opinion.