THE VALUATION LAW REVIEW

Volume 15, Issue 2
May 2009

Corporate/Securities Decisions and Certain Canadian Regulatory Developments

The Valuation Law Review summarizes corporate and securities decisions December 31, 2008 and regulatory developments as of March 31, 2009 (unless otherwise noted) 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 or securities regulator, as applicable.

The primary contributors to this publication practice corporate and securities law or litigation with the Toronto office of the firm of Ogilvy Renault LLP.

Editor:
Dera J. Nevin

Editorial Advisory Board:
Jeremy Grushcow
Tracey Kernahan
Steve Tenai

For subscription information please contact:
The Canadian Institute of
Chartered Business Valuators
277 Wellington Street West, 7th Floor
Toronto, Ontario M5V 3H2
Telephone: (416) 977-1117

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of the CICBV.

© Copyright CICBV 2009

The Canadian Institute of
Chartered Business Valuators
and Ogilvy Renault LLP

I. CANADIAN CASES

Page 9
BCE Inc. v. 1976 Debentureholders
Supreme Court of Canada
December 19, 2008
The Supreme Court of Canada rejected the existence of any priority rules (like maximization of shareholder value) to resolve conflicting interests of stakeholders in a change of control transaction. Where stakeholders interests conflict, it falls on directors to resolve them in accordance with their fiduciary duty to act in the best interests of corporation. What are in the bests interests of the corporation is a function of business judgment but also entails treating stakeholders affected by corporate actions in a fair manner, commensurate with the corporation's duties as a responsible corporate citizen.

Page 13
Metcalfe & Mansfield Alternative Investments II Corp., (Re)
Ontario Court of Appeal
August 18, 2008
The *Companies' Creditors Arrangement Act* permits third party releases in a plan of compromise or arrangement to be sanctioned by the court where the releases are reasonably connected to the proposed restructuring.

Page 16
AiT Advanced Information Technologies Corp. (Re)
Ontario Securities Commission
January 14, 2008
A disclosable material change does not occur during negotiations to a transaction when a Board decides to pursue a potential transaction that is not yet within its control to put into effect, unless the Board has reason to believe that the other party is also committed to completing the transaction.

Page 18
Deer Creek Energy Ltd. v. Paulson & Co. Inc.
Alberta Court of Queen's Bench
June 13, 2008
Dissenting arbitrageurs were not permitted to take advantage of a spike in the value of the shares after completion of the first stage in a two-stage amalgamation squeeze-out.

Page 21
First Capital Realty Inc. v. Sterling Centrecorp. Inc.
Ontario Superior Court of Justice
January 11, 2008
Dissenting shareholders cannot discontinue an action to have the court fix a fair value for their shares brought under to section 185(19) of the Ontario *Business Corporations Act* and revert back to the position of dissenting shareholders under a Plan of Arrangement.

Page 22
I.M.P. Group Ltd. v. Dobbin
Ontario Superior Court of Justice
September 16, 2008
This case resolved a dispute over a large block of shares that had, allegedly, been sold twice. The court ordered the shares to be delivered to the party that had agreed to buy the shares earlier in time, even though the block traded across the TSX in the name of the party that had subsequently bought it. This decision defines essential components of any transaction for shares including "delivery," "notice of adverse interest," "payment" and "registration."

Page 24
Teranet Inc. v. Canarab Marketing Corp.
Ontario Court of Superior Justice, Commercial List
October 15, 2008
A minority shareholder brought an application under section 185 of the Ontario *Business Corporation Act* to determine the fair value of shares following a proposed reorganization of Teranet. The valuation was impacted by a previous shareholders' agreement with the Province of Ontario.

Page 25
*V**alrut Investments Ltd. v. Norstar Commercial Developments***
Ontario Superior Court of Justice
April 7, 2008
In an application for the dissolution of a partnership in which the fair market value of the partnership assets may have been lower than cost, the court declined to follow a U.K. precedent which ordered a public auction rather than the sale of assets by one partner to the other at a fixed price.

Page 26
Wells v. Melnyk
Ontario Superior Court of Justice
July 16, 2008
A shareholder has a right to attend or not attend a shareholder meeting and to revoke a proxy at any time, absent a clear and binding agreement that restricts that right. A by-law amendment, including one to change the quorum required for a shareholder meeting, is "special business" and must be approved at a meeting of shareholders with proper notice given to shareholders.

Page 29
Silver v. Imax Corp.
Ontario Superior Court of Justice
May 6, 2008
Section 138.8 of the Ontario *Securities Act*, which allows for a statutory cause of action for misrepresentation in the secondary market, requires a plaintiff to obtain leave from the court in order for action to proceed. This decision concerns the permissible scope of the cross-examination on affidavits filed to support the leave motion.

Page 30
Ainslie v. CV Technologies Inc.
Ontario Superior Court of Justice
December 3, 2008
A proposed defendant cannot be compelled to file affidavit evidence for the leave motion under section 138.8(2) of the Ontario *Securities Act*, and must file an affidavit only where the defendant intends to lead evidence of material facts in response to the motion for leave.

II. U.S. CASES

Page 32
Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc., et al.
United States Supreme Court
January 15, 2008
Investors cannot assert securities fraud claims against secondary actors alleged to have aided or abetted violations of securities laws. This decision limits a plaintiff's ability to argue a "scheme liability" theory in an effort to reach defendants such as banks, accountants and lawyers who are alleged to be involved in issuers' misrepresentations to the public.

Page 35
Teamsters Local 445 Freight Division Pension Fund v. Dynex Capital Inc., et al.
United States Court of Appeals for the Second Circuit
June 26, 2008
There are instances where corporate scienter can be successfully pleaded even in the absence of successfully pleading scienter as to an expressly named officer or director.

Page 37
Edward T. Joyce, et al. v. Morgan Stanley & Co., Inc.
United States Court of Appeals for the Seventh Circuit
August 19, 2008
An investment banking firm that had been engaged by a target company to provide a fairness opinion in a merger transaction did not, by virtue of that engagement, owe fiduciary duties to target company's shareholders. This decision highlights the importance of the terms and language used in engagement letters.

Page 38
McPadden v. Sidhu
Court of Chancery, State of Delaware
August 29, 2008
Directors of a company will not necessarily have acted in bad faith in a change of control transaction when, among other deficiencies, these rely on an inherently unreliable fairness opinion based on financial information provided by the buyer which resulted in a valuation, and consequently a sale price, that was favourable to the buyer. However, officers of a company may continue to face litigation in such circumstances.

Page 40
Hexion Specialty Chemicals, Inc. v. Huntsman Inc.
Court of Chancery, State of Delaware
September 29, 2008
This decision, arising from one of several U.S. leveraged buyouts challenged by the credit crisis, highlights several significant issues relating to material adverse effect clauses, reverse termination fees, bank commitment letters and transaction agreements.

Page 43
Morrison v. National Australia Bank, Ltd.
United States Court of Appeals for the Second Circuit
October 23, 2008
The court considered whether the *Securities Exchange Act of 1934* gave it subject matter jurisdiction over a so-called "foreign-cubed" case in which foreign plaintiffs were suing a foreign issuer in an American court for violation of American securities laws based on securities transactions in foreign countries.

Certain Regulatory Developments

Page 45

New Rules on Executive Compensation

The Canadian Securities Administrators ("CSA") have introduced new executive compensation disclosure rules which address the quality of such disclosure. The purpose of the rules is to ensure investors receive comprehensive information about the value of all forms of compensation which certain executive officers of an issuer receive or may receive in a particular year. The new rules apply in respect of financial years ending on or after December 31, 2008.

Page 45

New Rules on Internal Controls Certification

National Instrument 52-109 – Certification of Disclosure in Issuers' Annual and Interim Filings came into effect December 15, 2008. The new rules expand the scope of the certification that Chief Executive Officers and Chief Financial Officers are required to give with respect to an issuer's interim and annual filings. Issuers are now required to adopt a control framework in the design of their internal controls over financial reporting ("ICFR") and the Chief Executive Officer and Chief Financial Officer must certify the framework adopted and that they have evaluated the effectiveness of the issuer's ICFR. The rules apply to financial periods ending on or after December 15, 2008.

Page 47

British Columbia Introduces Statutory Secondary Market Liability

British Columbia has enacted legislation providing for a statutory civil liability remedy for secondary market disclosure. The new legislation gives investors who acquire securities in the secondary market a right against issuers, directors, officers, experts and certain other persons connected with an issuer for written and oral misrepresentations contained in disclosure released in the marketplace and for failure to make timely disclosure of material changes. All provinces in Canada now have legislation in effect which provides for secondary market liability.

Page

TSX Rules Amended to Allow for Listing of Special Purpose Acquisition Corporations

On December 19, 2008, the Toronto Stock Exchange (the "TSX") amended its rules to allow the listing of Special Purpose Acquisition Corporations ("SPACs"). SPACs are issuers that at the time of an initial public offering of their securities and the listing of such securities on the TSX have no business operations but have an intention to acquire a yet unidentified operating business. Prior to the amendment of the TSX rules, issuers seeking listing were required to have an existing business and prescribed operating profits.

Page 48

Canadian Securities Regulators Propose Amendments to Corporate Governance Regime

On December 19, 2008, the CSA published proposals to amend the corporate governance regime applicable to public issuers in Canada. Proposed National Policy 58-201 – Corporate Governance Principles, National Instrument 58-101 – Disclosure of Corporate Governance Practices, National Instrument 52-110 – Audit Committees and Companion Policy 52-110-CP – Audit Committees, if enacted, will repeal and replace the existing governance regime in Canada. The proposals were published in response to criticism that the current governance regime is too prescriptive and may possibly be interpreted as setting minimum standards that may not be appropriate for all issuers. The proposed regime adopts a principles-based approach to corporate governance and disclosure.

Page 50

Certain U.S. Regulatory Developments

SEC Publishes Final Rule on Cross-Border Transactions
On September 19, 2008, the U.S. Securities and Exchange Commission published its final rule and guidance implementing changes to the cross-border exemptions for business combination transactions and rights offerings. The rule became effective December 8, 2008.

Summary of Caselaw, Legislative and Regulatory Developments 2008

In a year marked by extremes in volatility and uncertainty in the capital markets, Canadian courts responded to disputes brought before them with an eye to "business realities, not merely narrow legalities." The courts' responses and decisions suggested creative approaches and an awareness of the needs of capital market participants within a rapidly changing environment. The Supreme Court of Canada demonstrated that leave to appeal and hearings processes could accommodate a decision within the tight acquisition timelines for the proposed acquisition of BCE by the Ontario Teachers Pension Plan group, while the Ontario Superior Court's Commercial List remained responsive to the changing environment when seized with the task of approving the restructuring of the frozen Asset-Backed Commercial Paper market undertaken by the Crawford Committee. These courts delivered reasons quickly and in doing so issued reasons which provided guidance to corporations, boards of directors and their advisors when responding to market events.

In the BCE decision, the Supreme Court of Canada rejected the existence of any priority rules (like maximization of shareholder value) to resolve conflicting interests of stakeholders in a change of control transaction and specifically declined to endorse Delaware's "Revlon" line of cases. Rather, where stakeholders interests conflict, it falls on directors to resolve them in accordance with their fiduciary duty to act in the best interests of corporation. What are in the bests interests of the corporation is a function of business judgment but also entails treating stakeholders affected by corporate actions in a fair manner, commensurate with the corporation's duties as a responsible corporate citizen.

Decisions by Canadian courts and market regulators provided additional direction to corporations and their advisors in change of control situations. The Ontario Securities Commission found that a disclosable material change for one party to a transaction did not occur during negotiations where the other party to the proposed transaction had not yet decided whether to proceed with the transaction. An unusual decision that required the Ontario Superior Court to determine the ownership of securities in a company where the securities had, allegedly, been sold twice provides clarity to market participants by defining essential components of any transaction, including when and how beneficial ownership is affected during a transfer of shares through the CDS mechanism.

Several valuation cases were decided in a year marked by extreme volatility in securities prices. Although no novel propositions were articulated, courts noted that

dissenting shareholders were not entitled to certain things when exercising appraisal rights under corporate statues, namely: these could not take advantage of a spike in the value of shares after completion of the first stage in a two-stage amalgamation squeeze out; could not discontinue an action to have the court fix a fair value for their shares and revert back to the position of dissenting shareholders under a plan of arrangement; and, a partner could not apply to the court to order a public auction rather than the sale of assets by one partner to the other at a fixed price, particularly where the fair value of the partnership assets might be lower than cost.

The first decisions under the secondary market liability regime of the Ontario *Securities Act* were also released in 2008. To date, these decisions deal only with the preliminary issue of the scope of production and cross-examination on the motion for leave to bring an action. Nevertheless, these early decisions will impact the strategy of litigants in relation to leave motions in the future.

Courts in the United States continue to restrict the scope of securities fraud claims that investors can make against secondary actors alleged to have aided or abetted violations of securities laws. The United States Supreme Court has limited a plaintiff's ability to argue a "scheme liability" theory in an effort to reach deep pocketed defendants, including banks, accountants, and lawyers. Similarly, U.S. appellate-level decisions have confirmed that investment banking firms engaged by target companies to provide fairness opinions do not, by that engagement alone, owe fiduciary duties to that target company shareholders. However, a decision of the Delaware Chancery Court establishes the principle that corporate scienter can be successfully pleaded even in the absence of successfully pleading scienter as to an expressly named officer or director.

The U.S. courts also heard several cases brought in any effort to unwind several leveraged buyouts challenged by the credit crisis. In deciding these cases, U.S. courts have reviewed material adverse affect clauses and clauses providing for reverse termination fees. These decisions highlight the importance of carefully reviewing terms within transaction agreements and documents.

Canadian Securities Administrators introduced new executive compensation disclosure rules and proposed a new corporate governance regime. The Toronto Stock Exchange amended its rules to allow for the listing of special purpose acquisition corporations, which are issuers that have no business operations upon the initial public offering but an intention to acquire an as-yet unidentified operating business. A new CSA rule also expands the scope of the certification of the chief executive and chief financial officers in annual and interim filings. Now CEOs and CFOs must certify as to the control framework adopted by the issuer for the design of their internal controls over financial reporting and must also certify that they evaluated those controls.

The U.S. Securities and Exchange Commission published its final rule and guidance implementing changes to the cross-border exemptions for business combination transactions and rights offerings.

Certain Caselaw Developments

I. Canadian Cases

BCE Inc. v. 1976 Debentureholders
[2008] S.C.J. No. 37
Supreme Court of Canada
December 19, 2008

The Supreme Court of Canada ("**SCC**") overturned the Quebec Court of Appeal decision that had concluded that a proposed leveraged buyout of BCE Inc. **("BCE")** by a consortium of purchasers was not fair, and restored the decision of the Quebec Superior Court which had approved the $52 billion privatization of BCE as a fair arrangement. The SCC also dismissed the oppression claim brought by a group of Bell Canada **("Bell")** debentureholders, who alleged the deal was oppressive and unfair as it could result in a 20% decline in the short-term trading value of their debentures.

This SCC decision sets out principles that will aid in the interpretation of a director's duties as prescribed by the *Canada Business Corporations Act* ("**CBCA**") and the oppression and arrangement provisions. The court rejected a strictly shareholder-focussed understanding of the duty of a board of directors in change of control transactions, articulating instead a decision-making environment in which boards have to balance competing factors and interests when making decisions. The SCC proposed that the duty of directors to act in the best interests of the corporation includes a duty to treat individual stakeholders affected by corporate actions fairly. However, by affirming the role of the directors' business judgment, the SCC leaves to boards of directors room to make decisions, and the SCC's endorsement of the business judgment rule remains a counter-balance to the consideration that boards give to the corporation's stakeholders.

The decision also clarifies the threshold considerations for an oppression claim. Courts must examine whether the evidence supports the claim that a stakeholder had a reasonable expectation and whether that reasonable expectation was violated as a result of conduct that amounted to "oppression," "unfair prejudice" or "unfair disregard" of the relevant interest. In considering oppression claims, courts should look at "business realities, not merely narrow legalities."

The court attributed a portion of the corporate profits to the controlling shareholder under s. 18 of the Child Support Guidelines based on the history of the shareholder's deployment of corporate funds for his personal benefit.

Facts

The Deal

On June 30, 2007, BCE entered into a definitive agreement with a group led by the Ontario Teachers Pension Plan Board **("Teachers")** for the sale of all of BCE's outstanding shares, at a price of $42.75 per common share, which represented a premium of approximately 40% to the closing price of the shares in March 2007. The transaction would require approximately $52 billion in total capital, $38.5 billion of which would be supported by BCE. Bell, a wholly owned subsidiary of BCE, would guarantee approximately $30 billion of BCE's debt, with Teachers investing nearly $8 billion of new equity capital.

BCE's board of directors had reviewed three offers and, based on the recommendation of its Strategic Oversight Committee and opinions from several financial advisors, concluded that the Teachers' bid was in the best interests of BCE and its shareholders. The Board did not seek a fairness opinion with respect to Bell debentureholders, concluding that rights of the debentureholders were not being arranged in the deal. On September 21, 2007, BCE's shareholders approved the arrangement by a majority vote of 97.93%.

The Debentureholders Bring Suit

After the arrangement was announced, a group of Bell debentureholders opposing the deal brought an action in the Quebec Superior Court. The debentureholders noted that leveraged buyout of BCE would result in a significantly increased debt load for Bell and would reduce the value of the debentureholders bonds by approximately 20%. The credit ratings of the debentures also risked being downgraded from investment grade to below investment grade which could oblige debentureholders with investment credit-rating restrictions to sell their debentures at a loss.

The debentureholders sought relief under the oppression remedy provided for in section 241 of the *CBCA*. The debentureholders also opposed court approval of the proposed arrangement under section 192 of the *CBCA* on the basis that the deal was not "fair and reasonable" given the adverse effect on their economic interests.

The Quebec superior court approved the arrangement as fair under the *CBCA* and also dismissed the debentureholders' claims for oppression. The trial judge concluded that under section 122 of the *CBCA*, the directors of BCE had a fiduciary duty to act in the best interests of the corporation, which is distinct from the interests of shareholders or other stakeholders. This meant directors might have to approve transactions that, while in the best interests of the corporation, might affect some stakeholders at the expense of other stakeholders. The court also dismissed the debentureholders' oppression claim, noting that Bell's debt guarantee had a valid business purpose, did not breach the reasonable expectations of the debentureholders and did not render the debentureholders vulnerable in an oppressive manner. The trial judge also found that BCE and its directors had not unfairly disregarded the interests of the debentureholders

and that the application of the business judgement rule in this case meant that the court would defer to directors' business decisions so long as they are made in good faith and in the performance of functions they were elected by the shareholders to perform. The court approved the arrangement as fair and reasonable. The trial judge dismissed the debentureholders' claim for voting rights, given that their legal interests were not compromised by the arrangement. The trial judge held that it would be unfair to allow the debentureholders an effective veto over the overwhelming shareholder vote in favour of the transaction.

The Court of Appeal overturned the trial decision on the ground that BCE had not met the test for approval of the arrangement under section 192 of the *CBCA* by failing to show that the transaction was fair and reasonable to the debentureholders. The Court held that BCE was required to consider the non-contractual interests of the debentureholders and that the debentureholders had reasonable expectations above and beyond their contractual rights based on representations made by Bell over the years. As such, the directors had a duty not only to accept the best offer, but also to consider whether the arrangement could be restructured in a way that provided a satisfactory price to the shareholders while avoiding an adverse effect on the debentureholders. BCE did not do that. Because it rejected the arrangement on section 192 grounds, the Court of Appeal found it unnecessary to consider the oppression claim.

BCE and Bell subsequently appealed, arguing that the Court of Appeal erred in overturning the trial judge's approval of the plan. The debentureholders in turn cross-appealed on the Court's refusal to consider their oppression claim.

The Supreme Court of Canada Decision

The SCC allowed BCE's appeal, finding that the Court of Appeal incorrectly combined the substance of a section 241 oppression analysis with the test in the section 192 arrangement approval process. The debentureholders' cross-appeal was dismissed.

The Oppression Claim

The SCC found that the Court of Appeal had been wrong to subsume the oppression analysis in its analysis of whether the arrangement was fair and reasonable. These were different tests that involved different burdens on the plaintiffs and the corporation.

The SCC noted that in assessing a claim of oppression, a court must answer two questions: (1) Does the evidence support the reasonable expectation asserted by the claimant?; and (2) Does the evidence establish that the reasonable expectation was violated by the conduct falling within the terms "oppression," "unfair prejudice" or "unfair disregard" of a relevant interest?

Useful factors for determining whether a reasonable expectation exists include, but are not limited to: general commercial practice; the nature of the corporation; the relationship between the parties; past practice; steps the claimant could have taken

to protect itself; representations and agreements; and the fair resolution of conflicts between corporate stakeholders. The reasonable expectation inquiry will always, of necessity, be fact-specific.

Where conflicting interests arise, it falls to the directors of the corporation to resolve them in accordance with their fiduciary duty to act in the best interests of the corporation. The SCC clarified that this duty comprehends "a duty to treat individual stakeholders affected by corporate actions fairly and equitably" but there is no principle that one set of interests should prevail over another. In each case, the question is whether, in all the circumstances, the directors acted in the bests interests of the corporation having regard to all the relevant considerations, including the need to treat affected stakeholders in a fair manner. Where interests conflict, "there is no principle that one set of interests – for example the interests of shareholders – should prevail over another set of interests." The SCC specifically declined to endorse Delaware's "Revlon" line of cases.

In considering oppression claims, the SCC directed courts to look at "business realities, not merely narrow legalities." The reasonable expectations of stakeholders are the "cornerstone of the oppression remedy [and] are objective and contextual."

The SCC found that the debentureholders did not establish that they had a reasonable expectation that BCE's directors would protect their economic interests by approving a plan of arrangement that would maintain the investment grade and trading value of their debentures. The SCC agreed with the trial judge's findings with respect to deference under the business judgment rule and the content of the directors' fiduciary duty. The evidence established that BCE's directors considered the interests of the debentureholders and committed that the contractual terms of the debentures would be honoured, without further commitment. This fulfilled the directors' duty. There was no evidence that it was reasonable for the debentureholders to expect the directors to take positive steps to restructure the purchase in a way that would provide a satisfactory price to shareholders and preserve the high market value of the debentures. The debentureholders were aware that the value of bonds can fluctuate over time and that leveraged buy-outs are a feature of corporate finance and could have, but did not; seek contractual protections within the debentures to protect their interests.

Section 192 Approval

The SCC noted that the approval process for plans of arrangement under section 192 of the *CBCA* focuses on whether the arrangement, viewed objectively, is fair and reasonable. In seeking court approval of an arrangement, the onus is on the corporation to establish: (1) that the statutory procedures have been met; (2) that the application has been put forth in good faith; and (3) that the arrangement is "fair and reasonable." To find that an arrangement is fair and reasonable, the court must be

satisfied that the arrangement has a valid business purpose and the objections of those whose legal rights are being arranged are being resolved in a fair and balanced way.

Relevant factors for determining if these requirements have been met include: the necessity of the arrangement to the corporation's continued existence; the approval, if any, of a majority of shareholders and other security holders entitled to vote; where there has been no vote, whether an intelligent and honest business person, as a member of the class concerned and acting in his or her own interest, might reasonably approve of the plan; and the proportionality of the impact on affected groups.

A court should refrain from substituting its view of the "best" arrangement. The focus of the inquiry on a section 192 application is on the security holders whose *legal* rights are affected by the proposal. Here, only the debentureholders' *economic* interests and not their *legal* rights were affected by the transaction, as the investment and return they had contracted for remained intact. Because Bell's debentureholders did not fall within an exceptional situation where non-legal interests should be considered, the debentureholders did not constitute an affected class. The SCC therefore concluded that the trial judge was correct in finding that the debentureholders should not be permitted to veto the shareholder vote. Similarly, because it was well known that an increased debt load would cause fluctuation in the trading values of the debentures, the debentureholders could have contracted against this contingency. It was clear that the continuance of the corporation required acceptance of an arrangement with increased debt and guarantees by Bell. The SCC concluded that because there is no such thing as a perfect arrangement, the trial judge had correctly concluded the arrangement was both fair and reasonable.

Metcalfe & Mansfield Alternative Investments II Corp., (Re)
(2008) 296 D.L.R. (4th) 135
Ontario Court of Appeal
August 18, 2008

The Court of Appeal dismissed the appeal brought by a group of creditors objecting to a plan to restructure Canada's $32 billion Asset-backed Commercial Paper ("**ABCP**") market. The creditors alleged that the *Companies' Creditors Arrangement Act* ("**CCAA**") did not permit the court to sanction a plan that called for creditors to provide releases to third parties who are themselves solvent and not creditors of the debtor company and that the plan was neither fair nor reasonable as it called for creditors to provide releases to certain solvent third parties (some releases barring claims even in fraud) who were not even creditors of the debtor company. The Court of Appeal dismissed the appeal, holding that the CCAA permitted the inclusion of third party releases in a plan of compromise or arrangement to be sanctioned by the court where the releases were reasonably connected to the proposed restructuring. The Court of Appeal also found that the plan was fair and reasonable in all the circumstances.

Background

ABCP is a financial instrument primarily used as a form of short-term investment that usually yields a low interest only slightly better than government or short-term bank notes. The instruments were "asset-backed" in that the cash used to purchase an ABCP note was subsequently converted into a portfolio of assets that, in turn, provided security for the repayment of the notes. These assets often included residential mortgages, auto loans, and derivative investments such as credit default swaps. Certain financial institutions would then agree to provide funds to meet the demands of maturing ABCP notes. While ABCP was often marketed as a "low-risk" investment, if investors stopped buying (or rolling over) ABCP notes there would be no cash to repay maturing ABCP notes because of the inherent timing mismatch between the cash generated by the portfolio of assets and the cash needed to repay maturing ABCP notes.

Following widespread defaults on U.S. sub-prime mortgages, investors in the Canadian ABCP market experienced a loss of confidence which resulted in a liquidity crisis in the Canadian market for ABCP. On August 13, 2007, the market's major players agreed to freeze the $32 billion Canadian ABCP market while they attempted a market restructuring that would preserve the value of the ABCP notes.

The Plan

In March 2008, the Pan-Canadian Investors Committee, a group of 17 financial and investment institutions, put forward a market-wide Plan of Compromise and Arrangement (the **"Plan"**). The Plan would convert the noteholders' frozen ABCP into long-term notes that would trade freely but at a discounted face value. The goal of the Plan was to create a strong secondary market for the notes. In addition, the Plan called for more transparency, providing investors with detailed information about the assets supporting their ABCP notes. The maturity provisions and interest rates on the new notes would be modified, while the majority of the underlying assets were pooled.

Under the Plan, holders of ABCP notes were required to grant releases to third party financial institutions, even where those institutions were themselves solvent and were not creditors of the debtor company. These releases relieved virtually all the participants in the ABCP market, including ABCP note dealers, from any liability associated with ABCP except respecting certain narrow fraud claims. The releases would prevent actions against those institutions even where the creditor holders of ABCP notes may have had claims for relief arising from their purchase of those notes. The releases were a condition for certain key entities' participation in the Plan.

The Plan was ultimately approved by 96% of noteholders at a special meeting, consisting of a "double majority" of 99% of those connected with the development of the Plan and 80% of those not involved in its development. After the CCAA application judge initially refused to approve the Plan because he did not have sufficient facts to decide whether all the releases proposed in the Plan were authorized by the CCAA, the parties ultimately renegotiated a fraud carve-out for the ABCP note dealers and

brought the amended Plan back to the court for approval. The Ontario Superior Court of Justice sanctioned the Plan in June 2008.

A group of creditors collectively holding slightly over $1 billion in ABCP notes opposed the Plan and appealed the approval of the Plan to the Court of Appeal. Those creditors alleged that because the Plan called for creditors to provide releases to third parties, the lower court had erred in finding the Plan was fair and reasonable. These creditors argued that the CCAA did not allow such releases the courts were not entitled to "fill in the gaps" in the CCAA by reading in this jurisdiction, and the releases were an unconstitutional confiscation of private property made invalid under Quebec law.

The Court of Appeal held that the application judge had the authority under the CCAA to sanction the Plan so long as the third party releases were reasonably connected to the proposed restructuring. In this case there was a close connection between the claims being released and the restructuring proposal. Courts were required to interpret the CCAA liberally to facilitate compromises or arrangements between an insolvent debtor company and its creditors in the interests of all involved, including the wider public interest. The court was led to this conclusion by the combination of the open-ended, flexible character of the CCAA itself, the broad nature of the term "compromise or arrangement" as used in the CCAA, and the express statutory effect of the "double-majority" vote and court sanction which render a plan binding on all creditors including those unwilling to accept certain portions of it. As a result, the applications judge was entitled to treat the application as a restructuring of the entire ABCP market rather than an arrangement of the narrow affairs of debtors and their creditors. The application judge was also correct in sanctioning the parties' customized compromise arrangement, so long as it received the requisite double majority of votes. A number of court decisions in Ontario and other jurisdictions had approved the use of releases of third parties in other CCAA arrangements. The Court of Appeal specifically declined to follow earlier caselaw which suggested that the CCAA may not be used to compromise claims as between anyone other than the debtor company and its creditors.

The Court of Appeal was careful to note that not all releases between creditors of the debtor company seeking to restructure and third parties may be made the subject of a compromise or arrangement between a debtor and its creditors. There must be a reasonable connection between the third party claim being compromised in the plan and the restructuring achieved by the plan to warrant inclusion of a third party release. The Court of Appeal found the applications judge was correct in finding the nexus existed in this Plan.

The Court of Appeal also addressed the argument that the federal CCAA legislation interfered with established contractual or proprietary rights under provincial jurisdiction, including the right to bring an action. It held that the CCAA is valid

federal legislation under the federal insolvency power, and Parliament had sufficiently clothed the court with authority to consider and sanction a plan that contains third party releases in the "compromise or arrangement" language of the CCAA, combined with the statutory voting and sanctioning mechanism that makes the plan binding on all creditors.

The Court of Appeal also noted that there was no other legal impediment to the inclusion of the releases in a plan. The need to avoid litigation that would result if a broader fraud carve-out were allowed outweighed the negative aspects of approving releases with the narrower fraud carve-out provision. The application judge was not required to consider the interests of only the small group of dissenters, who represented a mere 3% of the ABCP market, but the interests of all ABCP noteholders. As the application judge had concluded that implementation of the Plan would work to the overall benefit of ABCP noteholders as a whole despite some creditors only benefiting marginally, the Court of Appeal agreed that the Plan was fair and reasonable in all the circumstances. No plan of the size and complexity as the Plan could satisfy all affected by it and operate perfectly, particularly when addressing a crisis of the magnitude presented by the frozen ABCP market. However, the size of the majority approving the Plan was testament to its overall fairness.

On September 2, 2008, the Supreme Court of Canada declined leave to appeal the decision of the Ontario Court of Appeal.

AiT Advanced Information Technologies Corp. (Re)
(2008) 40 B.L.R. (4th) 242
Ontario Securities Commission
January 14, 2008

This decision of the Ontario Securities Commission (the "**Commission**") holds that a disclosable material change does not occur during negotiations to a transaction when a Board decides to pursue a potential transaction that is not yet within its control to put into effect, unless the Board has reason to believe that the other party is also committed to completing the transaction.

Facts
Advanced Information Technologies Corporation ("**AiT**") sold systems to inspect secure travel documents, including passports. In early 2002, various meetings and discussions were held between the CEO of AiT and Steve Harrold ("**Harrold**"), the Manager of the Security Market Center at 3M Company ("**3M**"), a large American company regarding 3M's interest in acquiring AiT.

In March 2002, 3M conducted the first phase of its due diligence of AiT. In early April 2008, AiT formed a valuation committee. By April 25, 2002 the two sides had discussed and agreed upon a price to be paid for AiT. On April 25, 2005, AiT held

a Board meeting, where the Board unanimously approved recommending to the shareholders the acquisition by 3M for the price discussed; however, this approval was contingent on receiving a fairness opinion and subject to further AiT board approval.

The next day, AiT and 3M signed a Letter of Intent ("**LOI**"). By May 9th, 2002, 3M completed a second, and much more thorough, due diligence. Responding to marketplace rumours and inquires by Market Regulation Services regarding the high volume of AiT stock activity, AiT issued a press release stating AiT was exploring strategic options to enhance shareholder value. Following further negotiations and changes to the agreement, a final deal with 3M was approved by the AiT Board on May 21, 2002.

It was alleged that AiT contravened section 75 of the *Securities Act* (the "**Act**") by not disclosing forthwith the merger as a material change following the April 25, 2009, Directors' meeting. It was also alleged that Deborah Weinstein ("**Weinstein**"), a lawyer and a director of AiT, breached sections 122(3) and 127(1) of the Act by authorizing, permitting or acquiescing in AiT's failure to disclose, in a timely manner, the merger as a material change.

Decision of the Ontario Securities Commission

The Commission noted that timely disclosure of a material change is required to provide protection to investors from unfair, improper or fraudulent practices, and to foster fair and efficient capital markets and confidence in capital markets.

The Commission held that the determination of when a "material change" occurs is not a bright-line test and depends on the circumstances. The Commission noted that materiality may change based on the size of the companies involved and often occurs at a much lower threshold for smaller issuers than larger ones.

Because the negotiations of a potential acquisition transaction by 3M could reasonably be expected to affect the market price or value of AiT's shares, the negotiations were material. However, the fact that legal and financial advisors were retained is not determinative of the existence of a material change. Instead, a material change occurs when there are sufficient signs of commitment on behalf of all the parties involved to proceed with the transaction and a substantial likelihood that the transaction will be completed. A "decision by a board of directors of an issuer to pursue a potential transaction that is not yet within its control to put into effect (and therefore is not then capable of achievement), would not ordinarily be a material change in the business, operations or capital of an issuer at that point in time unless the Board has reason to believe that the other party is also committed to completing the transaction." When large and complex organizations such as 3M are involved, one also has to take into account the various levels of approvals that may be involved before a deal is concluded before the commitment can be established.

Based on the facts of this case, the Commission found that there was no material change in the three time periods in question: (1) the events leading to the original AiT board meeting of April 25, 2002; (2) the LOI signed by AiT and 3M on April 26, 2002; and (3) the time until May 9, 2002, ending with the second due diligence by 3M and the first press release by AiT because the required degree of commitment had not been reached by the parties at these times.

Since the Commission found no violation of section 75 of the Act by AiT, the charges against Weinstein under sections 122(3) and 127(1) of the Act were also dismissed.

Deer Creek Energy Ltd. v. Paulson & Co. Inc.
(2008) 49 B.L.R. (4th) 1
Alberta Court of Queen's Bench
June 13, 2008

A group of dissenting shareholders sought a higher price for their shares in Deer Creek Energy Ltd. ("**Deer Creek**") following a going-private transaction. The dissenters were arbitrageurs who had acquired their shares between the first and second steps of the transaction in anticipation of an increase in share price from an amalgamation between Deer Creek and Total E&P Canada Ltd. ("**Total**") and after Total advised of its intention to conduct an amalgamation squeeze-out, or second-step transaction. The dissenters rejected Total's $31 offer per share, claiming that their shares were worth more than triple that amount.

The court concluded that the dissenters were not permitted to take advantage of a spike in the value of their shares after completion of the first stage in the two-stage amalgamation squeeze-out. The court also rejected the dissenters' suggestion that a higher valuation was appropriate in light of future possibilities for the company, despite the company itself having made reference to these possibilities in its marketing.

Facts
Deer Creek was an Alberta company involved in the early stages of an oil sands project near Fort McMurray. Throughout much of 2005, Deer Creek had been in discussions with Total about a potential joint venture or asset sale. In August 2005, Total submitted a bid for Deer Creek's outstanding shares. At $25 per share, Total's bid represented a 39% premium over the trading price of its stock at the time. That bid was later increased to $31 per share after Total matched a competing offer. Total subsequently took up 82.4% of Deer Creek's outstanding shares, nominated a new Board, and scheduled a special shareholder meeting to approve privatization of the company.

The majority of shareholders approved the transaction, including more than half of the minority shareholders. The remaining minority shareholders complained that the $31 offer was too low, contending that the value of each share was at least $110 (and

possibly up to $200) in light of the company's future prospects. The dissenters also complained that the Board's process for determining Deer Creek's appropriate value had been inadequate.

The dissenting group brought a court application under section 191(3) of the *Alberta Business Corporations Act* seeking to be paid the "fair value" of their shares as at the last business day before approval of the going-private transaction.

The Board's Process

The court first examined the dissenters' claim that the process used by Deer Creek's Board to effect the transaction was inadequate and had inhibited higher competing offers. The judge rejected that claim, concluding that the process followed by the Board and the Board's negotiations had been diligent and that Deer Creek had considered many alternatives for the future development of its oil sands project. The Board had been actively engaged in evaluating the bid. The $31 price was a significant premium on Deer Creek's prior trading price. The Board had the right to decide against striking an independent committee, as the CEO's equity position was sufficient to avoid a conflict situation and the Board had satisfied itself that two of the directors nominated by Total and representing the minority interest were not under pressure to accept a bid.

The Business Judgment Rule

The court noted that the business judgment rule should not be applied to determine fair value in appraisal situations, and courts should not defer to the business judgment of management and directors on this point as fair value must be proved.

In any event, the court found that the Board's decision with respect to Total's bid was the right one at the time, so it was unnecessary to apply the rule. Deer Creek's decision not to conduct a public auction was a reasonable one given that the company had been actively discussing potential joint ventures with a number of partners prior to Total's bid. Because these partners were also all potential acquirers, the Board's decision to conduct a "controlled pre-market check" of other potential bidders was sufficient. The court also found that the deal protection terms were not anti-competitive and allowed other parties to bid in competition as evidenced by the fact that another bidder did.

Future Projections

The dissenters claimed that Deer Creek's marketing suggested a higher value for the shares was warranted in light of future possibilities for the company. Concluding that the dissenters were highly sophisticated investors and arbitrageurs, the judge found that they were not misled by the industry-standard presentations about the potential of the project, which was still in its early stages. In any event, some of the dissenters had not relied on the valuation information included in those presentations.

An Increase in Share Price After Stage One is Not Relevant

A key submission of the dissenting shareholders was that the court should consider market changes and the value brought to Deer Creek by Total in the time after it acquired control. After Total acquired a controlling share of Deer Creek, the price of the company's shares increased because Total had access to considerable financing. The court concluded, however, that where the intention to carry out a two-stage transaction is clear, dissenting shareholders cannot take advantage of a spike in the value of the company in the period between the two stages (i.e., post-merger but pre-squeeze-out). It was a general principle of Canadian law that a dissenting shareholder cannot benefit from an increase in the underlying share value created by a transaction against which the shareholder dissented. The securities laws that governed Deer Creek allowed this second stage transaction to proceed without an independent valuation, which was consistent with an underlying policy decision that no increase in value should accrue to dissenting shareholders by virtue of the completion of the first step in a two step acquisition process in the usual course. To hold otherwise could motivate some shareholders not to tender to the first stage bid in order to speculate on the potential upside in value that a majority shareholder may bring to the corporation in the short period of time before the squeeze-out transaction, leading to inequity in the treatment of shareholders. The court rejected the dissenting shareholder's position that there were "two distinct transactions," noting that acquirer had notified shareholders in the announcement of the bid that it intended to follow up with a squeeze-out transaction and should be treated by the market and the court as part of a single complete change of control transaction.

Market Value is Appropriate

While Deer Creek applied the "market value" method of share valuation, the dissenters argued that the "discounted cash flow" method was more appropriate. The court preferred the market value approach in light of all the relevant circumstances. The method advanced by the dissenters was less appropriate for companies in early stages of development. Similarly, the fact that almost all of the long-term shareholders of the company had agreed to the $31 offer suggested that the shareholders had received fair value. The court noted that the "net asset value" also supported the $31 bid.

The factors considered by the court in determining whether fair market value was awarded included whether there was an open market for the company's shares, whether the Board acted in a prudent and informed manner, and whether the nature of the two-step going private transaction affected the method for determining fair value.

The court also noted that while the timing of purchase and shareholder motivation should not be taken into account in the assessment of value generally, these factors may have a bearing on the exercise of the court's discretion to take into account synergies that may have accrued in the brief period of time between the first and second stages of this kind of transaction.

Conclusion

The court's view of the position of the dissenting shareholders appears to depart from the accepted principle that the timing of the purchase and the motivations of dissenting shareholders are not a consideration in dissent and valuation litigation. The dissenting shareholders in this case acquired most of their shares after the announcement of the initial Total offer. These were not long-term investors but were investors seeking to make short-term gains on the expectation of higher bids for Deer Creek shares (i.e., event arbitrageurs). The law has long held that all shareholders are to be treated equally irrespective of the timing of their share purchases or their motives. In other decisions, courts have also recognized that arbitrageurs create a market for securities that might not otherwise exist or be as robust.

First Capital Realty Inc. v. Sterling Centrecorp. Inc.
(2008) 163 A.C.W.S. (3d) 752
Ontario Superior Court of Justice
January 11, 2008

This case relates to the going private transaction of Sterling Centrecorp Inc. ("**Sterling**"), which was reported in Vol. 14, Issue 2 (June 2008). First Capital Realty Inc. and Gazit Canada Inc. were common shareholders of Sterling (together referred to as the "Applicants"). The Applicants were minority shareholders in Sterling, and opposed the going private transaction that was initiated by a group of inside directors and officers of Sterling. The transaction was being advanced under a Plan of Arrangement, and an Interim Order had already been issued.

The Applicants wanted to withdraw the action they initiated under section 185(19) of the Ontario *Business Corporations Act* (the "**OBCA**"), which provides that if a corporation fails to apply to the court to fix a fair value for the shares of the dissenting shareholders in the prescribed time, the dissenting shareholder can apply to the court for the same purpose. The Applicant sought to revert back to the status of dissenting shareholders under the Plan of Arrangement, so that these would receive $1.26 per common share received by the other common shareholders.

The court examined various sections of the Plan of Arrangement and section 185 of the OBCA and rejected the Applicant's request for the withdrawal of the action. Section 185 does not provide for discontinuance of an action bought pursuant to section 185(19) of the OBCA. Furthermore, the court found no language in the Interim Order, Plan of Arrangement or the disclosure in the Circular that would exempt the parties from the provisions of OBCA section 185. The court concluded that the withdrawal of the action did not entitle the Applicants to revert back to the position of dissenting shareholders under the Plan of Arrangement and receive $1.26 per common share.

I.M.P. Group Ltd. v. Dobbin
[2008] O.J. No. 3572
Ontario Superior Court of Justice
September 16, 2008

This case resolved a dispute over a large block of shares of Vector Aerospace Corporation (“**Vector**”) that had, allegedly, been sold twice. On December 20, 2005, I.M.P. Group Limited (“**IMP**”) allegedly made an agreement (the “**Agreement**”) with Mark Dobbin (“**Dobbin**”) and Killick Capital Inc. (“**Killick**”), through their agent Robert Foster (“**Foster**”) of Capital Canada Limited to purchase 4.1 million shares of Vector (the “**Shares**”)at a cost of $4.00 per share. IMP claimed that Dobbin and Killick breached the Agreement by selling the same shares to Donald K. Jackson (“**Jackson**”) for $4.07 per share later in the same day. IMP sued for an order for specific performance of the block of shares at $4.00 per share. Jackson was ordered to deliver the shares to IMP.

Facts

Without counting the Shares, IMP was the single largest shareholder of Vector, holding approximately 28% of the Vector’s shares. Dobbin and Killick were former executives of Vector and had left the company in a non-amicable manner that resulted in unresolved litigation. Together, Dobbin and Killick had accumulated approximated 12% of Vector stock. Jackson was the controlling shareholder and CEO of a private investment company, and replaced Dobbin as the Chairman of the Board, President and CEO of Vector in 2003.

In the late summer of 2005, Dobbin and Kilick decided to sell the Shares. They believed that there were two “natural purchasers” – IMP and Jackson. Since the principal of IMP, Rowe, was involved in directing the outstanding litigation, Dobbin and Killick decided to approach IMP (Rowe) through an agent. They told their agent Foster, that they were targeting $4.00 per share. Over the fall of 2005, Foster solicited Rowe’s interest in the Shares on many occasions. At the same time, Jackson had also been made aware that the Shares were for sale.

Both Rowe and Jackson were members of the Vector Board of Directors. At a December 15, 2005, Board meeting, it was confirmed that the Shares still had not been sold. During this meeting Rowe and Jackson arrived at a “gentleman’s agreement,” by which Jackson would buy the Shares on behalf of both Rowe and himself, and each would get half of the total. The litigation with Dobbin and Killick would be raised and potentially settled at the same time as the purchase.

In the days following the meeting each of Rowe and Jackson communicated with Foster and made efforts to acquire the Shares. Jackson was informed by Foster at 9:33 AM on December 20, 2005 that his original offer of $3.75 per share was rejected but that Dobbin would accept $3.90 per share. Foster also told Rowe that there was an above market value offer for the Shares.

Rowe, following through on the "gentleman's agreement," contacted Jackson to find out if Jackson knew about another offer. During this conversation Jackson admitted that the offer was on his behalf. Rowe ended the "gentleman's agreement." Rowe then called Foster and confirmed that Foster was authorized to sell the Shares. Foster and Rowe verbally agreed to the sale of the Shares to IMP at $4.00 per share at 10:00 AM. At 10:17 AM, Jackson and Dobbin talked on the phone and agreed on a $4.07 per share price for the Shares.

In the afternoon of December 20, 2005, Rowe saw a trade for 4.1 million Vector shares go though on the TSX. He contacted GMP, Jackson's brokerage, and put them on notice that the Shares were sold to IMP earlier in the day. At 4:52 PM, IMP's counsel sent a letter placing all parties on notice with respect to this transaction.

At the time of trial, the shares were trading at $5.50 per share.

The Court Decision

The court accepted Foster's evidence that he had been told by Dobbin to make an offer to Rowe on behalf of Dobbin. Foster had contemporaneous and detailed notes of the day, while Dobbin had no notes to confirm his side of the story. Furthermore, the court found no reason why Foster would hold himself out to be an agent for Dobbin if he had not been so authorized. The commission that he would receive from the deal did not justify the risk to his reputation.

Jackson argued that section 84 of the OBCA provides that a securities agreement is not enforceable unless "there is some writing signed by the party against whom enforcement is sought or by the party's authorized agent." The court held that the notes taken by Foster met the OBCA requirement of "some writing," accepting a liberal interpretation of the requirement that the writing be signed. Since Foster had written the essential terms of the contract (number of shares and price per share) and the names of the sellers in his own handwriting, the court was satisfied that the document met the requirement of being "signed."

The court found that specific performance should be awarded because damages would not be an adequate remedy as the transaction would have resulted in IMP having *de facto* control of Vector. Vector shares were thinly traded and IMP would have a difficult time buying the same block of shares in the open market, as there was no other seller.

The court ordered Jackson to deliver the remaining balance of undelivered shares to IMP at a price of $4.00 per share. The court found that Jackson had been put on notice of Rowe and IMP's prior claim to the Shares and that because this notice occurred before his transaction was settled through CDS, he was not a *bona fide* purchaser for value without notice.

IMP also asked for equitable damages in addition to specific performance to compensate IMP for the missed opportunity to make a take-over bid for Vector. Rowe had argued that if he had had the Shares, he would have been successful in a subsequent takeover bid for the rest of Vector at a range of $4.00 per share. The court rejected this argument by ruling that the success of the take-over bid was speculative.

This decision also interprets many sections of the CBCA and OBCA in light of modern commercial practices in the securities industry and defines essential components of share transactions including "delivery," "notice of adverse interest," "payment" and "registration."

Teranet Inc. v. Canarab Marketing Corp.
[2008] O.J. No. 4036
Ontario Court of Superior Justice, Commercial List
October 15, 2008

A minority shareholder in Teranet Inc. ("**Teranet**") brought an application under section 185 of the OBCA to determine the fair value of shares following a proposed reorganization of Teranet. This case is of interest because of the manner in which the valuation was impacted by a previous shareholders' agreement with the Province of Ontario.

Facts
Teranet is the vehicle through which the Province of Ontario set up an electronic land registration system in Ontario. The Province owned 50% of Teranet, while the remainder was owned by Teramira Inc. ("**Teramira**"). Teramira was a privately-held company owned by 30 shareholders, including Canarab Marketing Corp. ("**Canarab**") which owned 8% of Teramira.

In 2003, the Province sold its shares in Teranet to Teramira for $165 million. As part of the sale, the two entities entered into a Participation and Ownership Restriction Agreement ("**PORA**"), which restricted the disposition of both Teranet and Teramira shares. Under the PORA, the Province would receive a share of the proceeds of any disposition of Teranet shares in excess of a threshold price.

In 2006, Teramira began to monetize its interest in Teranet. It planned to amalgamate Teranet and Teramira and form an income trust by way of an initial public offering. This transaction needed various approvals, including that of the shareholders of Teramira. Canarab dissented and brought an application to be paid the fair market value of its shares.

The Fair Value Hearing
Teranet claimed that the shares were worth $54 million, while Canarab advocated a fair value range of $87.3 million to $91.8 million. The principal difference between these two ranges was determining the threshold price agreed to between the Province and

Teramira. Canarab claimed that the threshold price was $561 million, while Teranet argued that the price was $184 million. In the end, the court accepted uncontested affidavit evidence from Teranet that the $561 million number was an uncorrected error in the documents and should not be used for calculating the fair market value.

Canarab also argued that the valuation should consider future fee increases. Under the PORA, the Province could set all fee amounts. Teranet argued that any future increases were "remote" since there had been no increases in statutory fees in the previous 5 years. The court ruled that "remote" is not "impossible," and added a small contingency of $1.2 million to the valuation to account for potential future fee increases.

As for other issues in the assumptions (future royalties, growth rate of Teranet, the weighted average cost of capital, discount rate used, tax rates), the court generally accepted that the Teranet numbers were too pessimistic while Canarab's numbers were too optimistic. The court made upward adjustments to Teranet's expert's number. The court used the Teranet valuation's midpoint number of $54 million and added the adjustments determined during the hearing. The final valuation was determined to be $58.15 million. It is interesting to note that had Canarab not dissented in the original transaction, it would have received $60 million for the shares.

Valrut Investments Ltd. v. Norstar Commercial Developments
[2008] O.J. No. 1322
Ontario Superior Court of Justice
April 7, 2008

The court adjudicated a preliminary procedural motion in a dispute between partners seeking the dissolution of a partnership in which the fair market value of the partnership assets may have been lower than cost. The court declined to follow a U.K. precedent in which a U.K. court ordered a public auction rather than a sale of assets by one partner to the other at a fixed price.

Facts
Valrut Investments ("**Valrut**") and 915343 Ontario Inc. ("**915**") formed a partnership, Norstar Commercial Developments ("**Norstar**"), to engage in real estate development. In March 2004, Canaletto Investments Limited ("**Canaletto**") entered into an agreement (the "**Agreement**") to acquire some real property (the "**Property**") in trust for Norstar.

Before the transaction contemplated by the Agreement closed, the relationship between the partners deteriorated. Valrut brought an application (the "**Application**") asking the court for a declaration that Canaletto had breached its fiduciary duty, an order that 915 transfer its interest in the Agreement to Valrut for a fixed price equal to a *pro rata* share of the partnership's costs in relation to the Agreement and the Property and an order for the dissolution of the partnership.

Before the Application was a heard, 915 brought a motion seeking an order that the Partnership's interest in the Agreement be sold at public auction. In so doing, 915 was attempting to short-circuit the need for the Application by offering to proceed to a sale of the partnership's interest in the Agreement by public auction. Effectively, 915 did not want the court to order one partner to acquire partnership property at cost as opposed to fair market value. There was some evidence that the fair market value of the property might be less than cost, and that the relief sought by Valrut in its Application entailed a buy-out at fair market value or even an amount greater than fair market value.

915 argued that, in partnership breakdowns, the court cannot order the partnership property be allocated at cost rather than at fair market value. It advocated for an approach consistent with obiter comments in the House of Lords' decision of O'Neill *and Another v. Phillips and Others* where the court allowed an Application to be struck before a hearing where one party made an offer to dispose of or divide the Partnership interest at fair market value.

The Ontario court did not adopt this approach. It noted that the facts of this case were different than those in *O'Neill*. Valrut did not seek to be bought out at fair market value, and 915 did not offer to buy out Valrut at fair market value. Valrut instead was seeking to acquire 915's interest at a stipulated price, and 915 has not offered to sell at that price. The court found that if the law were to be expanded to adopt the principle expressed in *O'Neill*–that applications could be struck out at a preliminary stage on an offer being made to buy out a partner's interest at fair market value–this was not the case to do it. The court determined that there was evidence that selling the property in question at fair market value may be less than cost. The court rejected the preliminary motion, so that the final decision about the dissolution of the Partnership and the disposition of its assets could be made at the Application hearing.

Wells v. Melnyk
(2008) 92 O.R. (3d) 121
Ontario Superior Court of Justice
July 16, 2008

This decision arises out of proxy fight for control of the board of directors of Biovail Corporation ("**Biovail**"). Biovail and William Wells, the Chief Executive Officer and a director of Biovail, brought an application to validate the election of the board of directors at the shareholders' meeting on June 25, 2008 (the "**Meeting**"). The application was opposed by Eugene Melnyk ("**Melnyk**") and EM Holdings B.V. (collectively the "**Melnyk Parties**"). The results of the election of the Board were in doubt because the Melnyk Parties had withdrawn proxies prior to the Meeting, resulting in a loss of quorum. The Biovail Board had responded by passing a resolution which changed the quorum requirements for the Meeting. That resolution was not put to the shareholders

for approval at the Meeting. The Melnyk Parties claimed that the meeting was a nullity as there was no quorum and that a new meeting should be held. The court ordered the Meeting to be reconvened.

Facts

Following the notice of the Meeting, Melnyk issued a press release declaring that he would propose an alternate slate of nominees for Biovail's board of directors. Both then sides sent their proxy circulars to the shareholders and also agreed to guidelines for the conduct of the meeting (the "**Guidelines**"). The Guidelines provided that the meeting would be chaired by an independent person, Jonathan Levin ("**Levin**") and that the preliminary tabulation of the proxy solicitations would be revealed to both parties before the Meeting.

The tabulations revealed that the management slate would receive 62 million votes, while the Melnyk Parties' slate would receive 36 million votes, which included approximately 18.8 million shares directly or indirectly held by Melnyk. In total, the votes cast would represent approximately 64% of the outstanding Biovail shares.

On the morning of June 25, the proxy solicitation agent indicated that 60% of the outstanding shares would be represented. This revised total reflected revocation of a proxy representing approximately 6 million shares by RBC Capital Markets. Although no reason was given for the revocation, the Melnyk Parties attributed the revocation to a shift in shareholder sentiment to their favour.

Just before the start of the Meeting, Melnyk revoked his proxy of 17.9 million shares. The result was to reduce the number of outstanding shares represented at the meeting to less than 51%, the number required by Biovail's by-laws to constitute a quorum for the transaction of business at the Meeting. In response, the Board of Directors (the "**Board**") of Biovail convened a Board meeting just prior to the shareholders' meeting. The Board passed a by-law to reduce the quorum requirement to 25% (the "**By-Law Amendment**").

The Meeting then commenced and Levin was appointed the chairman. He advised the shareholders of the By-Law Amendment and ruled that the Meeting was properly constituted. The Board did not put the By-Law Amendment to a vote at the meeting. The voting for the slate of Board of the Directors was then initiated. The Biovail slate received almost 98% of the votes cast (the Melnyk Group did not vote) and were appointed as directors. The meeting was adjourned pending the outcome of this Application.

The Application to the Court

The court considered whether the Melnyk Parties had the right to revoke their proxies. The court accepted the general rule that a shareholder has a right to attend or not attend a shareholder meeting and to revoke a proxy at any time. The court found

that the manner in which the Melnyk Parties revoked their proxies did not violate this general rule.

The court also considered whether the Melnyk Parties were precluded from withdrawing their proxies based on the Guidelines. The court ruled that the Guidelines constituted a legally binding agreement between the parties. The court noted that the Guidelines were negotiated by parties that were highly sophisticated in commercial matters in the heat of a fierce proxy contest. The court reviewed the language of the Guidelines and found that they did not obligate the Melnyk Parties to vote their shares at the Meeting or to refrain from taking actions that would frustrate the holding of the Meeting or the election. There was no basis to imply a substantive term into the Guidelines, particularly one that would result in a renunciation of rights by the Melnyk Parties.

Similarly, the court found that the Guidelines contained no obligation not to make use of confidential information about the tabulation of proxies. The absence of such an obligation supported the court's conclusion that the parties did not agree that the Melnyk Parties were subject to a duty not to take any action to frustrate the holding of the meeting or the election of the winning slate of directors.

The court was also asked to determine whether the Meeting was properly constituted. Because the Melnyk Parties were lawfully able to revoke the proxies, it was undisputed that shareholders representing less than 51% of the outstanding shares were represented in person or by proxy at the Meeting. Unless the By-Law Amendment was valid and effective to reduce the quorum requirement for the Meeting to 25%, a valid quorum did not exist for the transaction of business including the election of directors.

Sections 103(2), 135(5) and (6) of the Canada *Business Corporations Act* ("**CBCA**") require that any special business has to be brought for a vote at the next shareholder meeting, with notice to the shareholders. A by-law amendment is considered to be "special business," therefore the change in the quorum number had to be approved at the Meeting with proper notice given to shareholders. This was not done in this case and thus the By-Law Amendment ceased to be effective at the Meeting.

The court also considered whether it could retrospectively validate the Meeting pursuant to section 144 of the CBCA. This section allows a court to order a meeting of shareholders when it would otherwise be impractical to call and conduct a meeting. The court found that this provision has been predominately used to protect legitimate majority shareholder rights in the private corporation context and is prospective and not retrospective. Therefore, it could not be used to validate the Meeting. The court also declined to exercise its inherent jurisdiction to validate the Meeting.

Finally, the Court also refused to validate the election of the directors under section 145 of the CBCA. This section provides the court with authority to determine disputes relating to the election of directors. The Court found that its authority under that

section was not unlimited and that the court did not have the authority under that section to deem an invalidly constituted meeting a validly constituted one, or to deem an invalidly elected Board a validly elected one, except in respect of deficiencies of a technical nature or deficiencies in which the applicant had acquiesced. Neither of those circumstances applied.

The Court also declined to exercise its inherent discretion to validate the election of the directors. The Court considered the circumstances under which it should exercise its discretion to validate an election of directors that occurred at an invalid meeting of shareholders in the absence of any acquiescence by the objecting party. The court found that Biovail failed to demonstrate the probability of material prejudice resulting from an inability to terminate the proxy contest at the Meeting. Furthermore, as there was no evidence of "significant economic harm" flowing from the uncertainty of the election, and it was possible to alleviate the uncertainty by establishing a date for a further meeting of shareholders for the election of directors, the Court declined to exercise its jurisdiction to validate the previous election.

The Court found that it was important that any order not affect the outcome of the proxy contest or alter the relative positions of the parties. The Court sought to restore the parties to their respective positions as at the time that the Melnyck Parties withdrew their proxies. The Court ordered the Meeting to be reconvened as soon as reasonably possible but not exceeding 90 days from June 25, 2008.

Silver v. Imax Corp.
[2008] 167 A.C.W.S. (3d) 881
Ontario Superior Court of Justice
May 6, 2008

This case is among the first actions brought under Part XXIII.1 of the Ontario *Securities Act* (the "**Act**") which allows for a statutory cause of action for misrepresentation in the secondary market. Section 138.8 of the Act requires a plaintiff to obtain leave from the court in order to bring an action for secondary market liability. This particular decision concerns the permissible scope of the cross-examination on affidavits filed to support the leave motion.

Facts
A proposed class action claim was commenced against Imax Corporation ("**Imax**") and certain other defendants alleging breaches of the secondary market liability provisions of the Act as well as negligent and fraudulent misrepresentation and conspiracy. The plaintiff alleged that Imax's presentation of its financial results between February 17, 2006 and August 9, 2006 did not comply with generally accepted accounting principles and was materially false and misleading.

As part of the motion for leave to bring the secondary market liability claims, both sides filed affidavit evidence. The deponents of the affidavits were then cross-

examined. Some of the Imax witnesses refused to answer some questions on their cross-examinations. They argued that they were not compelled to answer questions on cross-examination for a leave motion that would reveal confidential information. The other side challenged these refusals.

The Refusals Motion

Generally, the "semblance of relevance" test is used to determine whether a question should be answered in an examination for discovery. If the information to be elicited has a "semblance of relevance" to the issues of the action, then the question cannot be refused and must be answered.

Imax argued that a more stringent test than the "semblance of relevance" test should be applied because there were as yet no defendants to the statutory claim as a party needed leave from the court to start an action, and that there can be no pre-action right of discovery. Since section 138.8 is a "gatekeeper" provision that protects potential defendants against unmeritorious litigation, the court should adopt a restrictive approach to compelling the defendants to answer the questions.

The court rejected these arguments. It observed that the Act specifies that on a motion for leave, the plaintiff is required to put forth evidence that can then be tested via cross-examination. The potential defendant must also come forward with its defence and evidence to support its side of the story and that the Act "specifically requires the defendants to put forward information (presumably otherwise confidential and non-compellable information to the extent it may be relevant to their defence) and that specifically authorizes examination on such information." However, the Act does not provide for "the interpretation of the threshold test and what type, quality and quantity of evidence a court is to consider in making a determination of the plaintiff's good faith and the reasonable possibility of the plaintiffs' success at trial." The court is left with a mandatory requirement that the parties are to set out by affidavit the facts that each will rely on, with the right for cross-examination by the other side. She held that any question that has potential relevance to the facts alleged in the statutory claims that are set out in the statement of claim or the affidavits must be answered even if doing so may reveal some other issue or wrongdoing not contemplated by the statutory claim.

Leave to appeal this decision was denied.

Ainslie v. CV Technologies Inc.
(2008) 93 O.R. (3d) 200
Ontario Superior Court of Justice
December 3, 2008

This decision was released after *Imax* and also concerned the scope of evidence available on a leave motion under section 138.8(2) of the Act. The court held that a

defendant cannot be compelled to file affidavit evidence or attend for cross-examination under this section. A proposed defendant must file an affidavit only where it intends to lead evidence of material facts in response to the motion for leave.

Facts

A proposed action under the secondary market liability sections of the Act was brought against CV Technologies Inc. and three of its officers and directors (collectively referred to as "CV") and against CV's former auditors, Grant Thornton LLP ("**GT**"). It was alleged that CV had falsely represented that its 2006 fiscal year and 2007 first quarter financial statements were prepared and reported in accordance with generally accepted accounting principles. It was also alleged that GT was liable for negligence and negligent representation in connection with its audit of CV's financial statements.

The court was asked to interpret section 138.8(2) of the Act, which provides that upon an application for leave "the plaintiff and each defendant shall serve and file one or more affidavits setting forth the material facts upon which each intends to rely." CV had provided affidavits of two expert witnesses on which it intended to rely. GT filed no affidavit materials in response to the plaintiff's leave motion and intended to rely on the facts disclosed by the plaintiff's motion materials.

The plaintiffs sought to compel the defendants to file affidavits or otherwise be compelled to be examined under Rule 39.03 of the *Rules of Civil Procedure*. The defendants argued that the subsection could not be read to compel the filing of affidavits as it would improperly dictate the evidence on which the defendants could rely. Thus, the onus would shift from the plaintiff to the defence.

The court ruled that the purpose of section 138.8 is to protect defendants from coercive litigation and to reduce their exposure to costly proceedings. There is nothing in this section that requires the defendants to assist the plaintiffs in securing evidence upon which to base an action under Part XXIII.1 of the Act. The essence of the leave motion is that putative plaintiffs are required to show the propriety of their proposed secondary market liability claim before a defendant is required to respond. The court decided that the proper meaning of section 138.8(2) is that a proposed defendant must file an affidavit only where it intends to lead evidence of material facts in response to the motion for leave.

The court distinguished the decision in *Imax* by concluding that *Imax* was concerned with section 138.8(3) of the Act and not section 138.8(2). Section 138.8(3) relates to the scope of the examination of any affidavits filed under section 138.8(2). Any comments made on section 138.8(2) were deemed *obiter dicta*, specifically the ruling in *Imax* that section 138.8(2) prescribes a mandatory requirement for each plaintiff and each proposed defendant to set out the facts by affidavit with the right to cross-examine. In *Imax*, each of the defendants had elected to file an affidavit, and thus the court held that the ruling in *Imax* was based on different facts and did not specifically

address the interpretation of section 138.2(2).

The court also rejected the request to compel the defendants to be examined under Rule 39.03. An examination under Rule 39.03 is not justified if the purpose of the examination is to inquire into a party's defences or otherwise commence the discovery process before the close of pleadings. The court ruled that forcing the defendants to be examined under this Rule on the leave motion would amount to an abuse of process.

On February 11, 2009, leave to appeal was granted on the issue of whether the motions judge erred in concluding that s.138.8(2) of the Act did not require each defendant to file an affidavit in response to the plaintiff's motion for leave to bring a action.

II. U.S. Cases

Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc., et al.
United States Supreme Court
(2008), U.S. Sup. Ct. No. 06-43
January 15, 2008

The U.S. Supreme Court ruled that investors cannot assert securities fraud claims under section 10(b) of the *Securities and Exchange Act of 1934* ("*Exchange Act*") against secondary actors alleged to have engaged in transactions which aided or abetted violations of securities laws. This decision limits a plaintiff's ability to argue a "scheme liability" theory in an effort to reach defendants such as banks, accountants and lawyers who are alleged to be involved in issuers' public misrepresentations. This decision is another in a recent line of Supreme Court decisions which limits the scope of private securities law actions.

Facts
The claim stemmed from a variety of fraudulent practices undertaken by Charter Communications, Inc. ("**Charter**"), a cable operator, with the alleged assistance of Scientific-Atlanta Inc. ("**Scientific-Atlanta**") and Motorola, Inc. ("**Motorola**"), two of its suppliers and customers. A class action suit was filed against Charter, certain of its executives, its auditor, Scientific-Atlanta and Motorola alleging violations of section 10(b) of the *Exchange Act* and Securities Exchange Commission ("**SEC**") Rule 10b-5.

It was alleged that in late 2000, Charter executives realized that the company would not meet projected cash flow numbers. To try to meet these projections, Charter altered the structure of its contractual arrangements with Scientific-Atlanta and Motorola so that Charter would over-pay for supplies purchased from those companies. In return, Scientific-Atlanta and Motorola would purchase advertising from Charter to repay the overpayment. Supporting contracts were prepared in order to make the transactions appear to be unrelated and look legitimate in an attempt to fool the auditor, Arthur Andersen. Charter then used the advertising payments to inflate its revenue and operating cash flow to meet projections. The inflated number was shown on financial statements that were filed with the SEC and reported to the public.

Scientific-Atlanta and Motorola did not play any role in preparing or disseminating Charter's financial statements. However, it was alleged that they knew or were in reckless disregard of Charter's intentions to use the transactions to inflate its revenues and knew the resulting financial statements issued by Charter would be relied upon by research analysts and investors.

The district court and the Eight Circuit dismissed the *Exchange Act* section 10(b) claims concluding the plaintiffs alleged nothing more than aiding and abetting and did not show that Scientific-Atlanta or Motorola made misstatements relied upon by the public or violated a duty to disclose.

Majority Opinion

The decision of the majority of the U.S. Supreme Court was written by Justice Kennedy (the "**Court**"), who ruled that the section 10b-5 private right of action did not extend to the secondary actors (Scientific-Atlanta and Motorola) because Charter investors did not rely upon their statements or misrepresentations.

No "Scheme Liability"

The Court rejected the argument that "scheme liability" was applicable in this case and dismissed the argument that Scientific-Atlanta and Motorola had engaged in conduct with the purpose and effect of creating a false appearance of material fact to further a scheme to misrepresent Charter's revenue.

Citing a previous Supreme Court case, *Central Bank*, the Court endorsed the proposition that the conduct of the secondary actor needs to satisfy the following preconditions for liability: (a) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation. In this case, the alleged deceptive acts of Scientific-Atlanta and Motorola were too remote to satisfy the requirement for reliance. Charter had reported the fraudulent financial statements and Scientific-Atlanta and Motorola did nothing that made Charter record the transactions as they did.

The Court did acknowledge that a defendant can be liable for securities fraud even if it did not make a specific misleading oral or written statement, noting that conduct can be deceptive. The Court noted, consistent with *Central Bank*, that private securities fraud actions may be available against secondary actors who commit primary violations of securities laws.

Liability for Aiding and Abetting

The Court also rejected the argument that any aider and abettor is liable under section 10(b) of the *Exchange Act* and Rule 10b-5 if he or she commits a deceptive act in the process of providing assistance in the violation of securities laws. In amendments to securities laws, Congress enacted provisions to permit the SEC to pursue liability for aiding and abetting, but did not explicitly provide for such actions to be brought

forth by private parties. The Court ruled that adopting the petitioner's construction of section 10(b) would undermine Congress' determination that an aider and abettor should be pursued by the SEC and not by private litigants.

The Court also expressed the concern that to allow private litigants to pursue secondary actors could expose a new class of defendants to situations where extensive discovery, uncertainty and disruption could "allow plaintiffs with weak claims to extort settlements from innocent companies." The Court echoed the concerns of organizations such as the Organization for International Investment and NASDAQ, that to permit such claims could result in extra costs associated with being a publicly traded company in the United States, which could in turn deter overseas companies from doing business or offering securities in the United States.

Extension of the Private Cause of Action

The Court was also concerned about the expansion of the private cause of action beyond the securities markets into ordinary business operations, which the Court expressed would occur if the contractual arrangements involving Scientific-Atlanta and Motorola were reviewed under section 10(b) of the *Exchange Act* and Rule 10b-5. These contractual arrangements were regulated by state law and the Court was reluctant to extend federal jurisdiction into state matters. The Court concluded that any expansion of the private cause of action into new areas should be left to Congress.

Dissenting Opinion

Justice Stevens wrote a dissenting opinion on behalf of three justices. They found that Charter could not have inflated its revenues without the fraudulent actions of the defendants, and that the actions of Scientific-Atlanta and Motorola met the requirements of "deceptive devices" under section 10(b) of the *Exchange Act*. The dissenters distinguished the *Central Bank* case by noting that in that case the bank itself had not engaged in a deceptive act.

Justice Stevens also disagreed that the petitioner needed to allege that Scientific-Atlanta and Motorola made it "necessary or inevitable for Charter to record the transactions as it did" in order to establish a foundation for reliance. Citing a previous Supreme Court decision, *Basic Inc.*, Stevens J. held that investors do not need to be aware of a specific deceptive act that violates section 10(b) of the *Exchange Act* to demonstrate reliance. Furthermore, the fraud-on-the-market presumption does not say anything about causation from the respondent's side: what an individual or corporation must do in order to have "caused" the misleading information that reached the market. Here, a correct view of causation coupled with the fraud-on-the-market presumption would allow the petitioner to plead reliance. As the question of reliance had not been decided at the Court of Appeals, the case should have been sent back to that court for determination of whether the petitioner properly alleged reliance.

In response to the majority's concerns that a finding of liability would deter foreign

firms from doing business in the United States, Stevens J. noted that "investor faith in the safety and integrity of our markets is their strength" and provides sufficient basis to do business in the United States.

Justice Stevens also commented on the majority's "mistaken hostility towards the section 10(b) private cause of action," noting that the Court is wrong when it states that Congress did not impliedly authorize this private cause of action as a basis for refusing to extent it to secondary actors. "Congress enacted section 10(b) with the understanding that federal courts respected the principle that every wrong would have a remedy. [The majority's] decision simply cuts back further on Congress' intended remedy."

Teamsters Local 445 Freight Division Pension Fund v. Dynex Capital Inc., et al.
United States Court of Appeals for the Second Circuit
June 26, 2008

This case concerns whether scienter, the legal term for intention or knowledge of wrongdoing, can be found against a corporation without a finding of scienter against any individual officers or directors of that corporation. The Second Circuit Court of Appeals stated that there are instances where corporate scienter can be successfully pleaded even in the absence of successfully pleading scienter as to an expressly named officer or director.

Facts
Dynex Capital Inc. ("**Dynex**") invested in bonds secured by mortgages on manufactured housing. Between 1996 and 1999, Dynex's subsidiary, Merit Securities Corp. ("**Merit**"), made thousands of loans to purchasers of manufactured homes. The loans were pooled and issued as asset-backed securities with the income generated by the loans as collateral.

After the bonds were issued, the value of the collateral began to drop. As more people defaulted on their loans, the amounts realized from the sale of the properties following foreclosure declined. In October 2003, Dynex disclosed that it had understated the repossession rates associated with one of the bonds. In April 2004, Merit disclosed that it had uncovered "an internal control deficiency" related to how it recorded loan losses and needed to restate its earnings for two periods in 2003. Following these events, the values of the bonds decreased by up to 85%.

Teamsters Local 445 Freight Division Pension Fund ("**Teamsters**") who had bought $450,000 worth of bonds. It brought a class action against Dynex, Merit and certain officers and directors of those companies on behalf of all open market purchasers of the bonds between February 7, 2000 and May 13, 2004. Teamsters alleged that Dynex had "overtly" told dealers that they were willing to buy "bad paper" (i.e., very risky loans) and failed to disclose this in 1999 bond issue. Teamsters also alleged that Dynex and Merit "misrepresented the cause of the bond collateral's poor performance;

misrepresented the reasons for restating its loan loss reserves; and concealed the loans' faulty underwriting."

Dynex and Merit brought a motion to dismiss the case on the grounds that Teamsters had failed to properly plead scienter as required under section 21D(b)(2) of the *Public Securities Litigation Reform Act* (the "**PSLRA**"), which requires the plaintiff's complaint to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." The U.S. Supreme Court in *Tellabs, Inc. v. Makor Issues & Rights, Ltd* (discussed in Vol. 14, Issue 2) held that an "inference of scienter must be more than merely plausible or reasonable – it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent." The required state of mind has been interpreted as "a mental state embracing intent to deceive, manipulate, or defraud." Recklessness has also been found to be sufficient for culpable mental state in the securities fraud context.

The district court ruled that Teamsters had successfully pled scienter against the corporation but not against the two individuals, and struck out the claims against the individuals but not the corporation. Dynex and Merit appealed this decision, seeking to also have the claim against the corporation struck out.

The Decision

On appeal Dynex and Merit argued that since the district court did not find a strong inference of scienter against the officers, as a matter of law, such an inference could not be found against the corporation and the complaint should be dismissed. The Second Circuit Court of Appeals rejected this argument, stating that there are instances where corporate scienter could be pleaded in the absence of successfully pleading scienter in respect of an expressly named officer or director.

The Second Circuit Court of Appeals also ruled that Teamsters failed to adequately plead corporate scienter in this case, noting that the onus was on Teamsters to establish a "strong inference" of scienter.

Teamsters pleaded that Dynex "knew facts or had access to information suggesting that their public statements were not accurate." However, the court ruled that since Teamsters had not pleaded any specific reports or statements containing this information, it had not raised an inference of scienter in the complaint. Additionally, Teamsters pleaded and argued that "the defendants failed to review or check information that they had a duty to monitor." The court did not accept that an inference of scienter was proven without reference to any specific reports in the pleadings.

Teamsters pleaded that unspecified employees or officers of Dynex and Merit, and by inference, the corporations, benefited "in a concrete and personal way" from the alleged fraud. Teamsters argued that the motive was to avoid "fully disclosing the impaired quality of the collateral." The court rejected this argument, and ruled that the motive of appearance of profitability was not sufficient in securities fraud pleadings

because if "scienter could be pleaded on that basis alone, virtually every company in the United States that experiences a downturn in stock price could be forced to defend securities fraud actions."

The court concluded that Teamsters had failed to plead sufficient facts to overcome the inference that the bonds' poor performance was due to the general weakness in the market. Teamsters also failed to sufficiently plead that anyone at Dynex or Merit had the motive to deceive investors regarding the performance of the underlying collateral of the bonds. Without such pleadings, a strong inference of scienter could not be made out and the claim against the corporation was struck out. However, the case was remanded to the lower court and Teamsters was granted leave to amend its pleadings.

Edward T. Joyce, et al. v. Morgan Stanley & Co., Inc.
United States Court of Appeals for the Seventh Circuit
August 19, 2008

The United States Court of Appeal for the Seventh Circuit held that Morgan Stanley & Co. ("**Morgan Stanley**"), which had been engaged to provide a fairness opinion in a merger transaction, did not, by virtue of that engagement, owe fiduciary duties to the target company's shareholders. The engagement letter did not give rise to any contractual duties owed to shareholders; in addition, no extra-contractual fiduciary duties arose in the circumstances. This decision highlights the importance of the terms and language used in engagement letters.

Facts
The case was brought by certain shareholders and optionholders (the "**Shareholders**") of 21st Century Telecom Group, Inc. ("**21st Century**") against Morgan Stanley with regards to advice given by Morgan Stanley to 21st Century concerning a merger agreement between 21st Century and RCN Corporation ("**RCN**") in December, 1999. The merger involved RCN acquiring all the common shares of 21st Century.

After the merger agreement was signed, but before the effective date of the merger the price of RCN stock plummeted. The Shareholders claimed that although Morgan Stanley was acting as a financial advisor to the bidder, 21st Century, Morgan Stanley should have also given advice to the Shareholders about how to minimize their exposure to a potential loss of value of RCN stock. The Shareholders' claim was dismissed on a preliminary motion to strike.

The Decision
On appeal to the U.S. Court of Appeals for the Seventh Circuit, Morgan Stanley argued that the Shareholders had no standing to bring their claim as they had suffered no direct harm. The court accepted the Shareholders' claim that Morgan Stanley prevented them from taking hedging actions that could have protected them against losses in RCN stock values. After concluding that the Shareholders had a direct claim that could be brought against Morgan Stanley, the court looked at the merits of this

case – i.e., whether or not Morgan Stanley, which had been engaged by the bidder, owed a duty to the Shareholders.

The Shareholders alleged that Morgan Stanley knew that the Shareholders would rely on their fairness opinion and therefore Morgan Stanley owed the Shareholders the fiduciary duty of full and fair disclosure. The Shareholders also alleged that Morgan Stanley owed them an extra-contractual fiduciary duty to advise them about hedging.

The court rejected these arguments, ruling that for an extra-contractual fiduciary relationship to exist the allegedly superior party must have accepted a duty to guard the interests of the dependent party. There was no evidence that Morgan Stanley had ever accepted this responsibility towards the Shareholders. Furthermore, the engagement letter clearly indicated that Morgan Stanley was working for only 21st Century, the bidder, and not the Shareholders. The fairness opinion included a disclaimer that stated that the opinion was provided only to the Board of Directors and that the opinion expressed "no opinion or recommendation as to how the holders of the 21st Century Common Stock should vote at the shareholders' meetings."

The Court of Appeal for the Seventh Circuit cited an earlier decision it had rendered in 2008, *AA 2003 Liquidating Trust v. Credit Suisse Securities (USA) LLC*, in which shareholders claimed against an investment banking firm that had provided a fairness opinion. In both cases, the appeal court appears to have characterized the lawsuits by shareholders against the investment banking firm as an attempt to find a deep pocket to reach into to compensate investors for the blunders of the company or its management.

McPadden v. Sidhu
Court of Chancery, State of Delaware
August 29, 2008

The Delaware Court of Chancery considered whether directors and officers of a company acted in bad faith in a change of control transaction when, among other deficiencies, the board of directors relied on an inherently unreliable fairness opinion based on financial information provided by the buyer and that produced a valuation and sale price, favourable to the buyer. The court held that the actions of the board of directors were not the kind of "intentional dereliction of duty or the conscious disregard for one's responsibilities" that would constitute bad faith. For this reason, the court dismissed the suit against the directors on the ground that any breach of their duty of care was subject to an exculpatory provision in the company's charter. However, the court held that such exculpatory provisions applied only to directors and did not bar an action against an officer for breach of his duties.

Facts

The defendants in this action included several directors of a Delaware corporation, i2 Technologies, Inc. ("**i2**"). i2's charter included an exculpatory provision that protected i2's directors from liability to the fullest extent of Delaware law.

In 2001, i2 acquired Trade Services Corporation ("**TSC**"). The defendant Dubreville was CEO and president of TSC at the time of the acquisition and remained in charge of TSC. In 2002 and 2003, a competitor that TSC was suing for copyright infringement made several unsuccessful offers to purchase TSC, including an offer for $25 million. At the same time, the plaintiff alleged that Dubreville had engaged in a variety of actions designed to drive down the earnings of TSC.

In 2004, i2's board of directors decided to sell TSC. Although the board was aware of a proposed management buyout led by Dubreville, the board agreed to let Dubreville conduct the sale process, including finding a buyer for TSC. Dubreville's efforts to find a buyer were very limited and he did not approach the competitor who had previously offered $25 million for TSC.

The plaintiff alleged several "gross irregularities" in i2's approval of the sale of TSC to Dubreville's group. Among other deficiencies, i2's board relied on a fairness opinion and valuation that were based on financial information provided by Dubreville as an officer of TSC. The valuation was based on the buyer's own projections and financial statements. This process resulted in the acquisition of TSC by Dubreville's group for $3 million.

In 2005, Dubreville's group turned down an $18.5 million offer for TSC. In 2007, it sold TSC to another buyer for $25 million.

The Chancery Court's Decision

The Chancery Court began its analysis by noting that Section 102(b)(7) of Delaware General Corporation Law ("**DGCL**") exculpatory provisions in a Delaware certificate of incorporation can limit personal liability of directors for certain types of conduct but cannot exculpate directors for bad faith actions. The court then considered whether the actions of Dubreville and i2's directors constituted bad faith.

The court began by explaining that gross negligence does not normally constitute bad faith sufficient to preclude the use of an exculpatory provision. However, bad faith can be found if the misconduct rises to the level of "intentional dereliction of duty or conscious disregard for one's responsibilities."

The court found that the plaintiff had not alleged misconduct sufficient to constitute an intentional dereliction of duties but rather had alleged only that the defendants "acted with gross negligence or else reckless indifference." For this reason, the court held that the allegations amounted to a breach of the duty of care and were exculpated by the DGCL Section 102(b)(7) provision in i2's charter. Accordingly, it granted a motion to dismiss the action against the director defendants.

However, the court refused to grant a motion to dismiss against Dubreville, who was an officer but not a director. The court explained that "[t]hough an officer owes to the corporation identical fiduciary duties of care and loyalty as owed by directors, an officer does not benefit from the protection of a [DGCL] Section 102(b)(7) exculpatory provision."

Hexion Specialty Chemicals, Inc. v. Huntsman Inc.
Court of Chancery of Delaware
September 29, 2008

In litigation arising from one of several U.S. leveraged buyouts challenged by the credit crisis, the Delaware Court of Chancery agreed to enforce the terms of a US$10.6 billion merger agreement between two chemical companies, Hexion Specialty Chemicals ("**Hexion**"), a portfolio company of private equity firm Apollo Global Management, LLC ("**Apollo**"), and Huntsman Corporation ("**Huntsman**"). This decision, like the decisions of the Delaware Chancery Court in *United Rentals Inc. v. RAM Holdings, Inc. et al* (Vol. 14, Issue 2) and the Tennessee Chancery Court in *Genesco, Inc. v. Finish Line, Inc.*, *UBS Securities LLC et al.*, highlights several significant issues relating to material adverse effect ("**MAE**") clauses, reverse termination fees, bank commitment letters and transaction agreements.

Facts

This litigation arose from an agreement signed July 12, 2007 pursuant to which Hexion agreed to pay $28 per share in cash for 100% of Huntsman's stock for the total purchase price of $10.6 billion (the "**Agreement**").

The Agreement did not contain a "financing out" clause, which would have allowed Hexion not to complete the transaction if financing was not available. Instead, the Agreement contained a provision that if any portion of the financing became unavailable, Hexion was required to use its "reasonable best efforts" to obtain alternative financing. The Agreement provided for uncapped damages in the case of a "knowing and intentional breach of any covenant" by Hexion and for liquidated damages of $325 million in the case of other listed breaches. Hexion could walk away from the deal if the conditions in an MAE clause were met.

Hexion secured the deal by signing a commitment letter with affiliates of Credit Suisse and Deutsche Bank (the "**Lending Banks**"). This commitment letter required a "customary and reasonably satisfactory" solvency certificate from the Chief Financial Officer of Hexion, the Chief Financial Officer of Huntsman, or a reputable valuation firm as a condition precedent to the Lending Banks' obligation to provide financing.

Huntsman's 2008 first quarter numbers were disappointing, which led Apollo to meet with counsel to discuss how to terminate the transaction with limited or no liability. Possible options considered included: (1) that Hausman's declining performance was an MAE under the Agreement; and (2) that the combined post-merger company would be insolvent, making it impossible to obtain financing to complete the transaction.

On June 18, 2008, Hexion publicly released an insolvency opinion that showed that the merged company would fail all three tests of insolvency: (1) the balance sheet test; (2) the ability to pay debts test; and (3) the capital adequacy test. Hexion also sought

a declaratory judgment that, as a result of deteriorating operating results, Hausman had suffered an MAE and that Hexion was not obligated to complete the transaction and had no liability to Huntsman under the Agreement. In the alternative, in the event there was no MAE, Hexion argued that its liability for not completing the deal was limited to the US$325 million reverse break fee stipulated in the Agreement.

In response, Huntsman claimed that Hexion had knowingly and intentionally breached the Agreement and that Hexion's liability should not be limited to the $325 million reverse break fee. Huntsman also argued that here had been no MAE and that Hexion could not terminate the Agreement.

The Decision

The Court of Chancery ruled against each of Hexion's claims, finding that there was no MAE and that Hexion had knowingly and intentionally breached several covenants in the Agreement. The court ordered Hexion to perform its covenants under the Agreement, including taking all reasonable efforts to close the transaction, and enjoined Hexion and its affiliates from taking any further action to delay, impair or prevent either the financing or completion of the transaction.

This case, like *United Rentals*, is of interest because it highlights the U.S. courts' response to situations in which buyers seek to terminate transactions that have became economically unattractive by invoking MAE clauses. In such circumstances, courts have closely construed "deal protection" provisions including remedy clauses such as reverse break fees.

This case also highlights the attention that has been paid to such clauses by sellers in recent years. The result in the *Hexion* case arises from the seller-friendly terms negotiated by Huntsman, including: the no-financing condition, the requirement that Hexion use reasonable best efforts to complete the financing, and that the liability cap of $325 million for termination applied only to an inability to obtain financing, but not to breaches of other covenants.

Material Adverse Effect Clause

The Delaware Chancery Court has never found an MAE in a merger context. The court reconfirmed that the party invoking the MEA has a heavy burden, and has to prove that an MAE has occurred absent clear language to the contrary in an agreement.

Hexion had argued that Huntsman had repeatedly missed its earnings forecasts, which was a key factor in its MAE analysis. Although the court accepted in principle that the expected future performance of a target company may be relevant to a MAE analysis, Vice Chancellor Lamb rejected this argument by pointing out that the Agreement had explicitly disclaimed any representations or warranty by Huntsman with respect to such projections.

The court also observed that changes in corporate fortune must be examined in context, and a court must evaluate "whether there has been an adverse change in the target's business that is consequential to the company's long-term earnings power over a commercially reasonable period, which one would expect to be measured in years rather than months." In most cases, a short-term decline is not sufficient to invoke a MAE clause. Similarly, poor earning results must be expected to persist "significantly" into the future. In making such assessments, court may look to EBITDA, rather than EPS, as the benchmark to use, as EBITDA is a better measure of the operating results of the business because it is independent of capital structure whereas EPS reflects the effect of leverage and can be misleading.

Hexion also argued that its obligations to close was excused as a result of a MAE in the overall business of Huntsman and pointed to a carve-out in the MAE clause. The court rejected this argument, finding that carve-outs should not be considered unless there has first been an MAE. The carve-out in the MAE in the Agreement protected Huntsman if there were a catastrophe that impacted all chemical companies, including Huntsman. However, the opposite was not true and Huntsman's performance being disproportionately worse than the chemical industry did not constitute a MAE.

"Knowing and Intentional Breach" of the Agreement

The Agreement provided Huntsman with a reverse break fee in the amount of $325 million unless Hexion was found to have committed a knowing and intentional breach of the Agreement in which case Hexion's liability would not be capped. The court defined a knowing and intentional breach as "a breach that is a consequence of a deliberate act undertaken by the breaching party, rather than one which results indirectly, or as a result of the breaching party's negligence or unforeseeable misadventure."

The court objected to Hexion having sought an insolvency opinion without consulting Huntsman and in delivering this opinion to the Lending Banks. The court ruled that Hexion committed a "knowing and intentional breach" of several of its covenants under the Agreement by engaging in a course of conduct in which Hexion: (1) chose not to use reasonable best efforts to consummate the financing; (2) did not notify Huntsman of its concerns with the financing or meet with Huntsman to discuss the solvency problem; and (3) did not actively pursue antitrust clearance. The Court concluded that Huntsman would not be limited to the reverse break fee amounts in an action for damages caused by the merger not being completed.

Following this decision, and despite the efforts of Hexion and Huntsman to close the transaction, the Lending Banks refused to fund. Huntsman filed a suit in Texas against the Lending Banks, claiming that they interfered with the Agreement and in New York against the Lending Banks seeking specific performance by the banks of their funding obligations.

Morrison v. National Australia Bank, Ltd.
United States Court of Appeals for the Second Circuit
October 23, 2008

In this case the court considered whether the *Exchange Act* gave it subject matter jurisdiction over a so-called "foreign-cubed" case in which (1) *foreign* plaintiffs [were] suing (2) a *foreign* issuer in an American court for violation of American securities laws based on securities transactions in (3) *foreign* countries. The court declined to set a bright-line test but concluded that considering the circumstances, the court did not have subject matter jurisdiction because the conduct that had directly caused the harm occurred outside the United States.

Facts and Lower Court Decision
This case, brought under Section 10(b) of the *Exchange Act*, involved the National Australia Bank ("**NAB**"), a bank incorporated under Australian law and headquartered in Australia. NAB's shares traded on the Australian Stock Exchange, the London Stock Exchange, the Tokyo Stock Exchange and the New Zealand Stock Exchange. Although NAB's shares did not trade on any United States exchange, its American Depository Receipts ("**ADRs**") traded on the New York Stock Exchange. In 1998, NAB acquired HomeSide Lending, Inc., a mortgage service provider with headquarters in Jacksonville, Florida.

In 2001, NAB announced that HomeSide had used incorrect interest assumptions in its valuation model when calculating the present value of future fees from servicing mortgages. It had booked these fees on its balance sheet as an asset called a Mortgage Servicing Rights ("**MSR**"). NAB subsequently affected two rounds of write-downs in July and September of 2001 resulting from its recalculation of the value of HomeSide's MSR. After each write-down, the value of NAB's shares and ADRs fell sharply. In December, 2001, NAB filed an amended form 10Q, restating its financial statements to reflect the July and September write-downs.

Four purchasers of NAB shares brought suit in the Southern District of New York, alleging violations of Sections 10(b) and 20(a) of the *Exchange Act* and Rule 10b-5. The plaintiffs claimed that HomeSide falsified the value of its MSR in Florida and then sent the data to NAB in Australia where it was disseminated through public filings and statements. Three of the plaintiffs who purchased NAB shares outside the United States sought to represent a class of non-American purchasers. The district court granted the defendants' motion to dismiss for lack of subject matter jurisdiction as to the foreign plaintiffs.

The Second Circuit's Decision
The court began its discussion by noting that the *Exchange Act* makes no mention of the extent to which it confers subject matter jurisdiction. For this reason, the inquiry turns on "whether Congress would have wished the precious resources of the United

States courts and law enforcement agencies to be devoted to such transactions" given the "underlying purpose of the anti-fraud provisions." Following these principles and its previous case law, the court concluded that "it is consistent with the statutory scheme to infer that Congress would have wanted 'to redress harms perpetrated abroad which have substantial impact on investors or markets within the United States.'" Accordingly, the court typically applied a "conduct test" and an "effects test" to determine "whether the harm was perpetrated here or abroad and whether it affected domestic markets or investors." In declining to adopt a bright-line rule in "foreign cubed" cases, the court highlighted "the goal of preventing the export of fraud from America" and explained that "the United States should not be seen as a safe haven for securities cheaters."

In this case, the plaintiffs relied solely on the conduct test, arguing that the wrongful conduct occurred in the United States when HomeSide incorrectly valued its MSR. The court explained that subject matter jurisdiction exists under the conduct component if the activities "in the United States was more than merely preparatory to a fraud, particular acts or culpable failures to act within the United States directly caused losses to foreign investors abroad." In making this determination, the court considers "what and how much was done in the United States and what and how much was done abroad," and must determine "what is central or at the heart of a fraudulent scheme versus what is 'merely preparatory' or ancillary."

The plaintiffs alleged that HomeSide "manipulated its internal books and records" in Florida and then "sent the inflated numbers from Florida to NAB's headquarters in Australia." NAB then "created and distributed its public filings and related public statements from Australia." However, the court emphasized that HomeSide was a wholly-owned subsidiary of NAB and that, as the publicly owned company, it was NAB's responsibility to ensure the accuracy of its public filings and statements. In the end "the responsibility, as a practical matter, [lay] in Australia, not Florida." The court concluded that it did not have subject matter jurisdiction over the case because "the actions taken and not taken by NAB in Australia were . . . significantly more central to the fraud and more directly responsible for the harm to investors than the manipulation of the numbers in Florida." This conclusion was further supported by the lack of any support of subject matter jurisdiction under the effects component of the test and by the "lengthy chain of causation" between HomeSide's misdeeds and the misstatements that reached investors.

Certain Regulatory Developments

III. Certain Canadian Regulatory Developments

NEW RULES ON EXECUTIVE COMPENSATION DISCLOSURE

Effective December 31, 2008 the CSA amended National Instrument 51-102 – *Continuous Disclosure Obligations*. The amendments 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 or granted to a public issuer's key executive officers and how such compensation is determined. The new disclosure rules apply in respect of financial years ending on or after December 31, 2008.

Key requirements of the new rules 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. To allow a smooth transition to the new rules, issuers will not be required to include comparative disclosure in respect of financial years ending before December 31, 2008;
- 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 must 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 share and option-based awards;
- disclosure of the dollar value of non-equity incentive plans and pensions;
- 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 in tabular form.

NEW RULES ON INTERNAL CONTROLS CERTIFICATION

National Instrument 52-109 – *Certification of Disclosure in Issuers' Annual and Interim Filings* ("**N1 52-109**") came into effect December 15, 2008. The new rules expand the certification the chief executive officer ("**CEO**") and chief financial officer ("**CFO**") of a

public issuer are required to give with respect to an issuer's annual and interim filings by requiring enhanced certification with respect to internal controls over financing reporting ("**ICFR**"). NI 52-109 will apply in respect of financial periods ending on or after December 15, 2008.

The new rules 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 to NI 52-109 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 Accounts in England and Wales.

The CEO and CFO of a non-venture reporting issuer are 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 rules 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 are not 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 NI 52-109 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 new rules provided the issuer files the US certification and ICFR attestation report on management's assessment of ICFR with the Canadian securities regulator.

Venture issuers are not required to certify as to the design and effectiveness of ICFR or the establishment, maintenance and design of DC&P. Venture issuers are required to file 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 must, however, be included for readers.

SECONDARY MARKET LIABILITY IN FORCE IN BRITISH COLUMBIA

On July 4, 2008, amendments to the *Securities Act* (British Columbia) came into force which introduces a civil liability remedy for secondary market disclosure in British Columbia. Similar legislation has 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, Vol. 11, Issue 3.

As in Ontario, the British Columbia amendments make 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 reliance on a document or oral public statement containing a misrepresentation or on the issuer having complied with its timely disclosure obligations and does not have the burden of proving damages.

All provinces in Canada now have legislation in effect which provides for secondary market liability.

TSX RULES AMENDED ON DECEMBER 19, 2008 TO ALLOW LISTING OF SPECIAL PURPOSE ACQUISITION CORPORATIONS

On December 19, 2008, the Toronto Stock Exchange ("**TSX**") amended its rules to allow the listing on the exchange of Special Purpose Acquisition Corporations ("**SPACs**"). SPACs are issuers that, at the time of their initial public offering ("**IPO**") of their securities and the listing of such securities on the TSX, have no business operations but intend to acquire an unidentified operating business in the future. Prior to the amendment of the rules, the TSX required companies seeking listing to have an existing business and prescribed operating profits. The new rules allowing listing of SPACs follow the introduction of similar rules by NYSE and the American Stock Exchange.

The listing of a SPAC on the TSX is a two stage process. First, a prospectus relating to the securities of the SPAC must be filed and cleared with the relevant securities authorities. Upon successful completion of the IPO, the SPAC securities will be listed on the TSX. The TSX rules further require that at the time of listing the SPAC securities must have an aggregate market value of Cdn. $30,000,000. At least 90% of the IPO gross proceeds must be held in escrow pending consummation of a "qualified acquisition." Secondly, the SPAC must identify and, subject to the approvals of a majority of securityholders and a majority of directors unrelated to the acquisition, complete a qualifying

acquisition within 36 months of the closing of the IPO. Prior to seeking securityholder approval, a prospectus reflecting the proposed acquisition must be approved by the relevant securities regulatory authorities. An information circular must then be sent to securityholders inviting them to vote on the qualifying acquisition.

If an acquisition is not completed within the prescribed time frame then all IPO proceeds held in escrow must be returned to investors holding securities. The securities of the SPAC not subscribed for by the founding securityholders must have a conversion feature which allows securityholders that vote against a proposed qualifying acquisition to convert their securities into a *pro rata* share of the escrowed funds. Where units consisting of shares and share purchase warrants are issued in the IPO, the warrants may not be exercised prior to the completion of the qualifying acquisition. Such warrants will not give rise to entitlement of proceeds under the liquidation of the SPAC.

CANADIAN SECURITIES REGULATORS PROPOSE AMENDMENTS TO CORPORATE GOVERNANCE REGIME

On December 19, 2008, the CSA published proposals to amend the corporate governance regime applicable to public issuers in Canada. A Request for Comment was issued by the CSA in respect of Proposed National Policy 58-201 – *Corporate Governance Principles*, National Instrument 58-101 – *Disclosure of Corporate Governance Practices*, National Instrument 52-110 – *Audit Committees* ("**NI 52-110**") and Companion Policy 52-110 CP – *Audit Committees*. The public comment period for the proposals ended on April 20, 2009.

The proposals were published in response to criticism that the current governance regime is too prescriptive and may be interpreted as setting minimum standards of governance that may not be appropriate for all issuers. The proposals adopt a principles-based approach to corporate governance and disclosure. The existing governance guidelines have been replaced with nine broad governance principles. The new guidelines describe the following core corporate governance principles:

- *Create a framework for oversight and accountability*: an issuer should establish the respective roles and responsibility of the board and executive officers.
- *Structure the board to add value*: the board should be comprised of directors who will contribute to its effectiveness.
- *Attract and retain effective directors*: a board should have processes to examine its membership to ensure that directors, individually and collectively, have the necessary competencies and other attributes.
- *Continuously strive to improve the board's performance*: a board should have processes to improve its performance and that of its committees, if any, and of individual directors.

- *Promote integrity*: an issuer should actively promote ethical and responsible behaviour and decision making.
- *Recognize and manage conflicts of interest*: an issuer should establish a sound system of oversight and management of actual and potential conflicts of interest.
- *Recognize and manage risk*: an issuer should establish a sound framework of risk oversight and management.
- *Compensate appropriately*: an issuer should ensure that compensation policies align with the best interests of the issuer.
- *Engage effectively with shareholders*: the board should endeavour to stay informed of shareholders' views through the shareholder meeting process as well as through ongoing dialogue.

Each governance principle is accompanied by commentary describing the objective of the principle and examples of practices which may accomplish such objectives. The proposals recognize that other governance practices could achieve the same objectives, that corporate governance evolves as an issuer's circumstances change and that each issuer should determine its own corporate governance practices.

The current disclosure regime requires issuers to state that they comply with each prescribed governance practice or explain how they meet the objective of such practice. The proposals, if enacted, would introduce a more general disclosure obligation.

Finally, the proposals replace the current prescriptive tests of independence for directors and audit committee members with a principles-based test and accompanying commentary in NI 52-110. The current rule states that certain relationships a director has are deemed to preclude independence, thereby removing the determination of independence from the board of directors. The proposals amend the definition to provide that a director will be independent if he or she is not an employee or executive officer of the issuer and does not have, or has not had, any relationship with the issuer or an executive officer of the issuer, which could, in the view of the issuer's board of directors, having regard to all relevant circumstances, be reasonably perceived to interfere with the exercise of his or her independent judgment.

INTERNATIONAL FINANCIAL REPORTING STANDARDS – ADVANCED DISCLOSURE OBLIGATIONS

International Financial Reporting Standards ("**IFRS**") will become the mandatory accounting standards for all Canadian "publicly accountable enterprises" for financial years beginning on or after January 1, 2011. On May 9, 2008, the CSA issued CSA Staff Notice 52-320 – *Disclosure of Expected Changes in Accounting Policies Relating to Change-Over to International Financial Reporting Standards* (the "**Disclosure Notice**"). The Disclosure Notice provides guidance to issuers on disclosure of expected changes in accounting policies for the three financial periods immediately preceding the IFRS transition date. The Disclosure Notice outlines the CSA's view

that changing from Canadian GAAP to IFRS may materially affect an issuer's reported financial position and results of operations and may also affect business functions of the issuer. Therefore, the CSA is of the view that the market requires timely and meaningful information about such changes during the reporting periods leading up to the change-over from Canadian GAAP to IFRS. The Disclosure Notice sets out questions that an issuer should consider when making disclosure regarding its conversion to IFRS.

IV. Certain U.S. Regulatory Developments

SEC PUBLISHES FINAL RULE ON CROSS-BORDER TRANSACTIONS

The SEC published its final rule, effective December 8, 2008, that is intended to "address frequently arising issues and unintended consequences that have detracted from the usefulness of the existing cross-border exemptions"[1] previously in force.

The current cross-border exemptions provide for a two-tier rule. The Tier I category provides an exemption from most tender offer rules and from the registration requirements of Section 5 of the U.S. *Securities Act of 1933* available if U.S. holders own no more than ten percent (10%) of the subject securities. The Tier II category, applicable where U.S. security holders own more than 10 percent (10%) but less than forty percent (40%) of the target class, provides relief from some of the specific requirements of Regulation 14E, but does not relieve from compliance with the Section 5 registrations requirement or other aspects of the U.S. regime.

The main changes effected by the amendments are:

(1) The manner and timing of calculation of the U.S. holder percentages has been amended to allow use of data between sixty (60) days before and thirty (30) days after the public announcement of the transaction;

(2) Individual holders of more than ten percent (10%) of the securities no longer must be excluded from the calculation;

(3) An alternate test for the exemptions based on comparing the average daily trading volume (ADTV) of the securities inside and outside the U.S.

(4) Tier I affiliated transactions that would not previously have qualified for exemption from Rule 13e-3 requirements are exempt under the new rule – schemes of arrangement, cash mergers and compulsory acquisitions for cash – so long as these meet the Tier I requirements;

(5) Expansion of the Tier II provisions to tender offers not subject to Section 13(e) or 14(d) of the *Exchange Act*, and to eliminate many conflicts between U.S. and foreign law and practice; and

(6) Permitting early commencement for offers not subject to Section 13(e) or 14(d)

1 Securities and Exchange Commission, RELEASE NOS. 33-8957; 34-58597; FILE NO. S7-10-08, Section I.B.1.

of the *Exchange Act*, including offers for U.S. targets.

The final rule also equalizes beneficial ownership reporting requirements, permitting foreign institutions to report on Schedule 13G where applicable, rather than requiring those institutions to follow the 13(d) rules and report on Schedule 13D.