THE VALUATION LAW REVIEW

Volume 16, Issue 2
July 2010

Corporate/Securities Decisions and Certain Canadian Regulatory Developments

The Valuation Law Review summarizes corporate and securities decisions up to December 31, 2009 and regulatory developments as of June 15, 2010 (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.

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I. CANADIAN CASES

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Hudbay Minerals Inc. (Re)

Ontario Securities Commission

April 28, 2009

The Ontario Securities Commission ("**OSC**") held that out of fairness to shareholders, a shareholder vote would be required before a company would be permitted to issue additional common shares in an acquisition transaction. The proposed transaction would see an approximate 100% dilution of the company's outstanding shares. At the time the OSC decided this case, the TSX did not generally require shareholder approval for the acquisition of public companies based solely on the level of dilution. Following the decision, however, the TSX announced that listed issuers would now need to obtain shareholder approval when the number of securities issued in payment for the acquisition of a company exceeds 25% of the number of outstanding securities (on a non-diluted basis), regardless of whether the target company is public or private.

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Silver v. IMAX Corp.

Ontario Superior Court of Justice

December 14, 2009

The Court certified Canada's first secondary market liability suit for misrepresentation under the civil liability provisions of the *Securities Act*. In doing so, the Court set a relatively low threshold for plaintiffs seeking leave to proceed with a civil action for secondary market liability under the relevant provisions of the *Securities Act*.

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Alberta Court of Appeal

August 31, 2009

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Neo Material Technologies Inc. (Re)

Ontario Securities Commission

September 1, 2009

The OSC dismissed an application to remove a target company's shareholder rights plan so that a hostile take-over could proceed. The plan, which had received significant shareholder approval, had been adopted shortly after the take-over bid was announced. In an apparent departure from previous practice, the OSC concluded that the board was entitled to use such a tactic if doing so was in the best interests of the target corporation and its shareholders.

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Western Canadian Coal Corp. (Re)

Ontario Securities Commission

January 14, 2009

The Director of the OSC exempted a Canadian company from compliance with requirements to obtain minority approval of a proposed loan arising in the context of a related party transaction. The proposed loan had to be repaid on tight timelines such that obtaining minority approval would prevent the transaction from taking place. The company still had to obtain minority approval in respect to the transaction, failing which, the loan would have to be repaid.

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Certicom Corp. v. Research In Motion Ltd.

Ontario Superior Court of Justice

January 19, 2009

The Court blocked Research In Motion Limited ("**RIM**") from advancing a hostile take-over of Certicom Corp. ("**Certicom**"). In preparing its take-over bid, RIM had used certain confidential financial information obtained from Certicom pursuant to two earlier non-disclosure agreements. In light of the agreements, the Court held that RIM was prevented from using Certicom's confidential financial information to launch a hostile bid.

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Lucero v. ID Biomedical Corp.

British Columbia Court of Appeal

February 5, 2009

A British Columbia Court dismissed an action brought by warrant holders who had sold their warrants in a company that was the subject of a takeover. The plaintiffs claimed that they suffered damages as a result of selling their warrants for a lower price than the price that was ultimately approved by the Court. The plaintiffs alleged that the company concealed an informal committee's challenge to the valuation of the warrants, which would have caused the plaintiffs not to sell their warrants. In rejecting the claim, the Court refused to extend fiduciary obligations to holders of the corporation's warrants. The B.C. Court of Appeal upheld the decision.

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Nortel Networks Corp. (Re)

Ontario Court of Appeal

November 26, 2009

The Court upheld a decision to include severance and termination pay among payments that would be stayed under the *Companies Creditors Arrangement Act*, particularly with reference to the company's then-current financial situation.

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Eddie Bauer of Canada Inc. (Re)

Ontario Superior Court of Justice (Commercial List)

July 30, 2009

The Court approved a deal arising from a Stalking Horse process that had been initiated by both the U.S. and Ontario Courts in connection with a cross-border restructuring.

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Allen v. Aspen Group Resources Corp.

Ontario Superior Court of Justice

December 4, 2009

The Court certified a proposed class action in which allegations were made against a company, its directors and officers, and the law firm employer of one of the directors. The allegations included that information had been misrepresented in the context of a takeover bid, leading to a drop in share price following the transaction.

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Research In Motion Ltd. (Re)

Ontario Securities Commission

January 27, 2009

The OSC settled a proceeding in which it laid allegations against certain directors and officers of RIM in relation to disclosure and practices surrounding the grant of stock options. The agreed-upon settlements included payment by the officers of high administrative penalties and temporary restrictions on their ability to act as directors of reporting issuers. Substantial financial undertakings were also given.

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Asset-Backed Commercial Paper Settlements

On December 21, 2009, Quebec's Autorite des marches financiers ("**AMF**"), the OSC, and the Investment Industry Regulatory Organization of Canada ("**IIROC**") reached settlements in connection with the Canadian asset-backed commercial paper ("**ABCP**") market. In total, the settlements provided for the payment of $138.8 million in administrative penalties and investigation costs.

II. NON-CANADIAN CASES

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Bluebrook Ltd. (Re)

England and Wales High Court (Chancery Division)

August 11, 2009

Bluebrook Limited ("**Bluebrook**") sought the Court's approval of three schemes of arrangement under the U.K. *Companies Act 2006*. A group of subordinated creditors challenged Bluebrook's valuation, which showed that it was only able to satisfy its debts to other secured creditors. The Court rejected the challenge to the schemes, concluding that the subordinated lenders' legal rights were not affected.

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Ryan v. Lyondell Chemical Company, et al.

Delaware Court of Chancery

August 29, 2008

During a motion for summary judgment in a shareholder class action, the Delaware Supreme Court reaffirmed director exculpation provisions in the context of corporate merger transactions, and upheld the high bar to actions alleging breach of loyalty against independent directors.

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In Re NYMEX Shareholder Litigation and Greene v. New York Mercantile Exchange Inc.

Delaware Court of Chancery

September 30, 2009

In two parallel actions, certain shareholders attempted to challenge an already consummated merger. The plaintiffs alleged breaches of the fiduciary duties of loyalty, due care and candour in respect of the transaction. The Court dismissed all the claims in keeping with the approach outlined in the 2009 decision *Lyondell Chemical Co. v. Ryan*, reiterating the considerable deference provided to an independent board of directors facing a change of control.

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San Antonio Fire & Police Pension Fund v. Amylin Pharmaceuticals Inc., et al.

Delaware Court of Chancery

May 12, 2009

The Delaware Court of Chancery held that the board of directors of Amylin Pharmaceuticals, Inc. ("**Amylin**") had the power to "approve" a slate of nominees for election to the board for the purposes of a trust indenture agreement while simultaneously recommending and endorsing its own alternative slate of nominees.

III. CERTAIN CANADIAN REGULATORY DEVELOPMENTS

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Federal Government Proposes Canadian Securities Legislation

On May 26, 2010 the Government of Canada released proposed federal securities legislation which marks a key step towards its commitment to establish a Canadian securities regulator. The proposed legislation would apply as provinces and territories opt in, with the objective of having a single national securities regulator. Concurrent with the release of the proposed legislation, the Government referred the proposed legislation to the Supreme Court of Canada for an opinion on its constitutionality.

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Communication by Reporting Issuers with Beneficial Owners of Securities

On April 9, 2010 the Canadian Securities Administrators (the "**CSA**") published for comment proposed amendments to National Instrument 54-101 *Communication with Beneficial Shareholders of Securities of a Reporting Issuer* and related policies and instruments. The proposals, if enacted, will permit reporting issuers to satisfy the delivery requirements for annual meeting materials by posting the materials on a website other than SEDAR. The proposals recognize the development of internet communications and will increase the cost efficiency of shareholder communications.

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New Insider Reporting Regime

A new reporting regime for insiders of Canadian public issuers, reflected in National Instrument 55-104 *Insider Reporting Requirements and Exemptions* and its Companion Policy, took effect on April 30, 2010. The new regime reduces the deadline for filing insider trading reports from 10 calendar days to 5 calendar days and reduces the number of insiders required to file insider reports.

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Proposals to Amend Mining Disclosure Rules

On April 23, 2010 the CSA published for public comment amendments to National Instrument 43-103 *Standards of Disclosure for Mineral Projects*. The proposed amendments streamline the disclosure requirements for mining issuers and include proposals to accept foreign standards and professionals and to repeal or reduce certain existing disclosure requirements which were difficult to comply with in practice.

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Update on Implementation of International Financial Reporting Standards

On May 21, 2009 the CSA issued Staff Notice 52-324 *Issues Relating to Changeover to International Financial Reporting Standards*, an update on the changeover to IFRS standards in Canada. On February 5, 2010 the OSC published OSC Staff Notice 52-718 *IFRS Transition Disclosure Review* which focuses on the disclosure issuers have made in filings with respect to their implementation of IFRS. Canadian publicly accountable enterprises will be required to adopt IFRS in lieu of Canadian GAAP, for fiscal years beginning on or after January 1, 2011.

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New Registration Regime

A new registration regime for persons and companies participating in the Canadian capital markets took effect on September 28, 2009. The new regime which is contained in National Instrument 31-103 *Registration Requirements and Exemptions* and Companion Policy 31-103 CP *Registration Requirements and Exemptions* consolidates, modernizes and largely harmonizes registration requirements across Canada. It will affect not only existing registrants but may also require registration of other entities operating in the capital markets who were not previously required to be registered.

Page 47

TSX Rules Amended to Require Security Holder Approval of Public Companies by TSX Listed Issuers

On November 24, 2009 the Toronto Stock Exchange (the "**TSX**") adopted amendments to its Company Manual. The amendments require TSX listed issuers to obtain security holder approval where they propose to issue securities in connection with the purchase of a public company where the securities to be issued exceed 25% of the TSX listed acquiror's outstanding securities (on a non-diluted basis).

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Canadian Securities Regulators Abandon Proposals to Amend Corporate Governance Regime

On December 19, 2008 the CSA published proposals to amend the corporate governance regime applicable to public issuers in Canada which is outlined in 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*. The CSA indicated on November 13, 2009 that, as a result of public comments received on the proposals, they do not intend to proceed further with the proposals.

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Variation of Take-over Bids

On December 18, 2009 the CSA published CSA Staff Notice 62-305 *Varying the Terms of Take-Over Bids* which outlines CSA staff's view of variations made to a formal take-over bid which result in the bid being less favourable to target security holders. Variations identified by the notice include lowering the consideration offered, changing the form of consideration (other than to add to the consideration already offered), lowering the proportion of outstanding securities subject to the bid and adding new conditions to the bid.

IV. CERTAIN U.S. REGULATORY DEVELOPMENTS

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No More Sarbanes-Oxley Exemptions for Small Companies

Following the implementation of the Sarbanes-Oxley Act's internal control provisions in 2003, smaller public companies have been granted repeated extensions with respect to certain compliance obligations that were felt to be too onerous. The last of these extensions will expire this year.

Summary of Caselaw, Legislative and Regulatory Developments 2009

The year 2009 saw a flurry of hostile and friendly takeover bids which gave courts in both Canada and the United States occasion to consider shareholder rights and remedies, as well as the duties of boards of directors, surrounding valuation issues. In some cases, individual directors and officers faced increased potential liability for alleged misconduct by the companies they served. In others, boards of directors were afforded considerable deference in their management of proposed transactions.

In the *HudBay* decision, the Ontario Securities Commission (the "**OSC**") held that fairness to shareholders required that a vote be taken in advance of the issuance of additional, dilutive shares by a company in the context of a proposed acquisition. This decision caused the Toronto Stock Exchange ("**TSX**") to change its Company Manual accordingly. Shareholders were also bolstered by a decision by the Alberta Court of Appeal reversing a costs award granted against dissenting shareholders who challenged the valuation of their shares in the context of a takeover transaction. The Court held that dissenting shareholders were entitled to test the value of their shares in such a context. In *Neo Material Technologies*, a company had implemented a widely-approved shareholder rights plan that would frustrate an existing unsolicited bid. The OSC upheld the plan as a legitimate board tool for maximizing the best interests of the target corporation and its shareholders.

At the end of the year, the Ontario Superior Court of Justice issued the first decision interpreting and applying the test for leave under the secondary market liability provisions of the *Securities Act* in *Silver*. The Court found that the test did not set a high threshold for plaintiffs to obtain leave to pursue an action under those provisions. The proposed class action alleging misrepresentation in financial statements and press releases was certified. It remains to be seen how other courts will treat this decision and the leave test going forward.

Shareholder rights were not always bolstered in the case law, however. In *Lucero v. ID Biomedical Corp.*, the British Columbia Court of Appeal upheld a lower court ruling that a corporation did not owe a fiduciary duty to its warrant holders. In the United States, courts made it difficult for shareholders to succeed in claims against directors for breach of fiduciary duty or duty of loyalty in the context of proposed merger transactions.

At the other end of the spectrum, directors and officers in Canada came under increased scrutiny in both the regulatory and civil liability contexts. In *Allen*, a director and his employer were allowed to remain as defendants in a certified class action alleging misrepresentation in a bid circular. In the OSC case

involving RIM directors and officers, significant personal financial penalties were agreed to and implemented as a result of an allegedly improper options-granting practice.

Creditors seeking to upset plans of arrangement met with resistance from the courts in the *Nortel* and *Bluebrook* decisions. These cases illustrate the courts' overriding interest in taking a realistic assessment of an insolvent corporation's capacity (or lack thereof) to meet its ongoing obligations while restructuring progresses.

Finally, just before the end of the year, settlements in the asset-backed commercial paper ("**ABCP**") situation were entered into among various regulatory bodies. The settlements involve payment of over $138 million in administrative penalties and costs.

Certain Caselaw Developments

I. CANADIAN CASES

Hudbay Minerals Inc. (Re)

(2009), 32 OSCB 3733
Ontario Securities Commission
April 28, 2009

The OSC recently made use of its seldom-exercised statutory power to review decisions made by the TSX. The OSC overturned a TSX decision that had allowed HudBay Minerals Inc. ("**HudBay**") to issue, without shareholder approval, additional common shares in HudBay to the shareholders of Lundin Mining Corporation ("**Lundin**"), a company being acquired by HudBay.

Facts

HudBay is an integrated base metals mining, metallurgical processing and refining company whose common shares are listed on the TSX. In late November 2008, HudBay publicly announced a deal to acquire all of the outstanding common shares of Lundin, an international mining company headquartered in Toronto. Under the deal, Lundin would become a wholly owned subsidiary of HudBay. The transaction would see HudBay issue an aggregate of 157,596,192 additional common shares to Lundin shareholders at a ratio of 0.3919 HudBay shares for each share of Lundin. This more than doubled the number of outstanding shares of HudBay. Accordingly, the dilution experienced by the existing shareholders of HudBay would be over 100% upon the close of the transaction. Both sets of existing shareholders would each hold approximately 50% of the combined entity. Following the announcement, HudBay shares fell approximately 40% in trading on the TSX.

The proposed arrangement between HudBay and Lundin was structured as a plan of arrangement for Lundin under the *Canada Business Corporations Act*, such that Lundin's shareholders were required to approve the deal, but HudBay's shareholders were not.

Jaguar Financial Corporation ("**Jaguar**") owned approximately 1% of the outstanding shares of HudBay (1,500,000 shares). On December 9, 2008 Jaguar filed written submissions with the TSX requesting that the exchange exercise its discretion under sections 603 and 604 of the *TSX Company Manual* to require HudBay to obtain the approval of its shareholders for the issuance of the additional shares. Jaguar submitted that the quality of the marketplace would be affected by the size of the transaction. Jaguar also argued that the over 100% dilution would have a material effect on both the control of HudBay and on its corporate governance practices.

The TSX Decision

Where the number of securities issued in payment of the purchase price exceeds 45% of the issued and outstanding shares of the listed issuer, the *TSX Company Manual* requires the issuer to obtain shareholder approval for the issuance of securities as consideration for the acquisition. While that provision did not apply to acquisitions of public companies at the time this transaction took effect, the *TSX Company Manual* nonetheless required shareholder approval of transactions that would "materially affect control" of the listed issuer.

While it recognized that it had the authority to do so under section 603 of the *TSX Company Manual*, the TSX concluded that it would not be appropriate to use its discretion to require shareholder approval in these circumstances. Instead, the TSX conditionally approved the listing of the additional HudBay shares, subject to the receipt of certain documentation. Shareholder approval would not be required.

The OSC Decision

Jaguar applied to the OSC for relief. Among other things, Jaguar asked the OSC to set aside the TSX decision pursuant to its authority under sections 8(3) and 21.7 of the *Securities Act*. Jaguar also sought orders requiring HudBay to call and hold a meeting of its shareholders and prohibiting HudBay from closing the deal with Lundin without majority approval.

Before it could decide the merits of Jaguar's application, however, the OSC first had to decide if it could even interfere with a decision of the TSX. Because new and compelling evidence had been presented to the OSC that had not been shown to the TSX, the OSC concluded that this was an appropriate case to consider intervention.

The OSC then reviewed the TSX decision with an eye to Sections 603 and 604 of the *TSX Company Manual*. Section 604 requires the TSX to consider the effect of the transaction on the control of the company, including whether negotiation of the transaction occurred at arms length. In this case, the OSC was satisfied that the TSX had considered the proper factors and opted to defer to the TSX decision.

Section 603, however, requires the TSX to inquire as to the effect of the proposed transaction on the quality of the marketplace. Here the OSC concluded that there was no evidence in the minutes of the Filing Committee meeting that the TSX had assessed the effect of the transaction in this way. As a result, the OSC was required to consider this matter.

The OSC found that "quality of the marketplace" is a broad concept relating to both market quality and integrity. An assessment of a transaction's effect on the quality of the marketplace requires "a careful consideration of all the relevant

facts and circumstances and a balancing of all the relevant considerations that bear on that assessment." Based on the wording of Section 603, the OSC concluded that the TSX must consider at least the factors enumerated in that section, which include: the size of the transaction relative to the liquidity of the issuer, the listed issuer's corporate governance practices, and the material effect on control of the listed issuer. In addition, the OSC looked to other non-enumerated factors, including:

(a) Extent of dilution

(b) Economic impact on shareholders

(c) Corporate governance
  (i) board of merged entity
  (ii) timing of shareholder meetings

(d) Transformational impact of the transaction on HudBay and its shareholders

(e) Fair treatment of HudBay shareholders

The Commission held that "fair treatment of shareholders is a key consideration going to the quality and integrity of our capital markets." Concluding that it would be "manifestly unfair" to HudBay shareholders to permit the transaction to proceed without a shareholder vote, the OSC set aside the TSX decision and ordered that HudBay shareholders be asked to approve the deal.

The Impact of the HudBay Decision

The TSX Response

At the time the OSC decided the HudBay case, the TSX did not generally require shareholder approval for the acquisition of public companies based solely on the level of dilution. Following the decision, however, the TSX announced that listed issuers would now need to obtain shareholder approval when the number of securities issued in payment for the acquisition of a company exceeds 25% of the number of outstanding securities (on a non-diluted basis), regardless of whether the target company was public or private.

Pre-Acquisition Private Placements

Prior to concluding the transaction with Lundin, HudBay had subscribed for and acquired 19.9% of Lundin's common shares through a private placement. The result was an ability by HudBay to exercise its newly acquired voting rights in favour of the transaction with itself.

In its decision, the OSC commented that acquirers should not generally be entitled to influence the outcome of a merger vote simply by carrying out a

subscription of shares in advance of the transaction. For the OSC, this was because the acquirer has a "fundamentally different interest in the outcome of the transaction" than the already-existing shareholders of the target company.

While the OSC made no actual finding on this point in *Re HudBay*, the Alberta Securities Commission (the "**ASC**") soon weighed in on this debate. In *Re ARC Equity Management (Fund 4) Ltd.*,[1] the ASC considered a request for relief made by ARC Equity Management ("**ARC**") relating to a proposed transaction between three companies: Profound Energy Inc. ("**Profound**"), Paramount Energy Trust ("**Paramount**") and 1463072 Alberta Ltd. ("**1463072**"). Under the proposed deal, Paramount and 1463072 were to acquire 19.9% of the common shares of Profound by way of a private placement. The private placement was announced simultaneously with a proposed take-over bid by Paramount for all of the outstanding common shares of Profound. If Paramount complied with the requisite minimum-tender condition of the bid (taking up shares tendered to the bid representing over 50.1%), Paramount's total holdings of Profound shares would allow it to assure completion of a second-step amalgamation. This was coupled with a new shareholder rights plan that precluded any shareholder already holding over 20% of Profound shares from acquiring more than an additional 0.25% of shares. Indeed, when Paramount took up 59.4% of Profound's shares - bringing its total holdings of Profound shares to approximately 67% - the amalgamation seemed assured.

ARC, Profound's largest shareholder (with 31% interest), asked the ASC to bar Paramount and 1463072 from acquiring additional Profound shares if they purported to use their newly acquired shares to vote in favour of the merger. Alternatively, ARC sought shareholder approval of the private placement. ARC cited *Re HudBay Minerals Inc*. as authority for the proposition that "an acquirer should not generally be entitled, through a subscription for shares carried out in anticipation of a merger transaction, to significantly influence or affect the outcome of the vote on that transaction."

However, the ASC was not swayed. Because the OSC's comments in *HudBay* were mere commentary - rather than an actual ruling on the point - the ASC concluded it was not bound by the OSC decision. Instead, the ASC refused to exercise its public interest jurisdiction to prevent the privately placed shares issued to Paramount and 1463072 from being voted in connection with the ultimately friendly take-over. While the ASC noted that the tactical use of the private placement was not ideal – and potentially unfair to ARC – the ASC determined that the practice fell short of abusive conduct warranting intervention. In particular, the ASC noted that the private placement constituted a legitimate financial tool that would provide Profound with much-needed liquidity if the Paramount bid ultimately failed. The ASC also noted that the

1. 2009 ABASC 390

publicly disclosed transaction did not preclude a superior offer by a third party – and in fact required Paramount to vote its newly acquired Profound shares in favour of any superior offer. The shareholder rights plan adopted by Profound was also found to apply equally to all shareholders. Although it may have precluded ARC from acquiring additional shares, the plan was not discriminatory.

Though it went on to dismiss ARC's application, the ASC noted that a policy response may be warranted

Silver v. IMAX Corp.

[2009] O.J. No. 5585 (Ont. S.C.J.)
Ontario Superior Court of Justice
December 14, 2009

The Court certified Canada's first secondary market liability suit for misrepresentation under the civil liability provisions of the *Securities Act* and set out an interpretation of the test for granting leave to bring such an action. The Court set a relatively low threshold for plaintiffs seeking leave to proceed with a civil action for secondary market liability. A global class consisting of Canadian and international shareholders was certified, regardless of whether the shares were purchased on the TSX or NASDAQ. The Court accepted as a common issue – to be determined at trial – whether reliance can be inferred from purchases made on a stock exchange.

Facts

IMAX Corp. ("**IMAX**") is an entertainment technology company with shares listed on both the TSX and NASDAQ.

In 2005, IMAX released its audited financial results, followed by press releases outlining IMAX's revenues and indicating that the company was in compliance with Generally Accepted Accounting Principles ("**GAAP**"). On August 9, 2006, however, IMAX disclosed that the U.S. Securities and Exchange Commission (the "**SEC**") was conducting an informal inquiry into IMAX's financial results, particularly with respect to the timing of IMAX's revenue recognition and the company's use of multiple element arrangement accounting to recognize revenue from theatre systems that were not yet open. The day after the announcement, the price for IMAX shares dropped by 40%. In 2007, IMAX restated its financial statements for previous years (including 2005), acknowledging that the company had erred in recognizing revenue from theatre systems not yet opened, a practice contrary to GAAP.

The plaintiffs, Ontario residents who had purchased shares of IMAX, brought a class action against IMAX on behalf of a global class including anyone who purchased IMAX shares, regardless of their place of residence. Among other

things, the purported class alleged that IMAX had made negligent and reckless misrepresentations in its financial statements and related press releases, which the plaintiffs ultimately relied on to their detriment. The claim also sought to advance a secondary market liability claim for misrepresentation under the *Securities Act*.

The Secondary Market Liability Claim

Section 138.3 of Ontario's *Securities Act* provides for a civil right of action where an issuer releases a document containing a misrepresentation. Specifically, the Act provides a civil remedy to anyone who acquires or disposes of the issuer's shares during the period between the time when the document containing the alleged misrepresentation was released and the time when the misrepresentation contained in the document was publicly corrected. Unlike at common law, section 138.3 does not require the shareholder to have relied on the issuer's misrepresentation. The Act further allows for claims against the company, individual directors and officers, and those who influenced the issuer's misrepresentation. To take advantage of the statutory civil remedy for secondary market liability, however, claimants are required to seek leave of the court pursuant to section 138.8 of the Act.

Justice van Rensburg of the Ontario Superior Court of Justice had occasion to be the first judge to consider the leave test under section 138.8. In so doing, the Court established a relatively low threshold for the plaintiffs to meet. To obtain leave, the Court will only require plaintiffs to:

(a) establish that they are bringing their action in the honest belief that they have an arguable claim and for reasons that are consistent with the purpose of the statutory cause of action (not for an oblique or collateral purpose); and

(b) lead credible evidence that would permit the Court, after reasoned consideration, to conclude that the plaintiffs had a reasonable possibility of success at trial.

Should the defendants seek to rely on a "reasonable investigation" or other statutory defence, the Court held that the defendants bear the onus on a leave motion of satisfying the Court that there is evidence that such a defence will foreclose the plaintiff's reasonable possibility of success at trial.

Under the test, Justice van Rensburg concluded that the plaintiffs had met their burden for leave.

The Certification Decision

The plaintiffs advanced both statutory and common law misrepresentation claims. To determine whether the plaintiffs' action should be certified as a class proceeding, the Court considered the five statutory requirements for certification outlined in section 5(1) of the *Class Proceedings Act*. Despite previous decisions at common law refusing to certify secondary market actions because of the need to prove individual reliance on the alleged misrepresentations, the Court ultimately certified the plaintiffs' claims against IMAX.

The Pleadings Disclose a Cause of Action

The Court agreed with the plaintiffs that the pleadings disclosed a cause of action against IMAX in both negligent and fraudulent misrepresentation. In doing so, Justice van Rensburg rejected IMAX's argument that the company owed no duty of care to the plaintiffs. Concluding that it was not plain and obvious that no such duty existed, the Court noted that there may be policy reasons for recognizing a duty of care.

The Court also rejected IMAX's argument that the plaintiffs' action should fail because they failed to plead that every individual member of the proposed class relied on IMAX's alleged misrepresentations. The plaintiffs, on the other hand, claimed that the mere act of purchasing IMAX securities was a form of reliance sufficient to meet the requirement for a misrepresentation claim. While the U.S. "fraud on the market" theory had previously been rejected in Canada, Justice van Rensburg preferred to leave to trial a determination of IMAX's reliance argument.

The Class Definition

The plaintiffs proposed a global class definition including all persons, regardless of residence, who acquired IMAX securities on either the TSX or NASDAQ between February 17, 2006 and August 9, 2006, and who still held those securities as at the close of trading on August 9, 2006. While IMAX argued that the class should be limited to Canada, Justice van Rensburg held that an international class could be certified so long as there was a real and substantial connection between the claims asserted on behalf of the foreign class members and the jurisdiction of the Court. The Court certified a global class despite the existence of parallel class proceedings against IMAX in the United States.

The Common Issues

The plaintiffs initially proposed seventeen common issues. While rejecting the common issues relating to IMAX's alleged negligence, which Justice van

Rensburg struck as a cause of action, the Court ultimately certified most of the proposed common issues. Of particular note, the Court accepted as common issues for trial the following issues:

(a) whether the mere fact that the class members purchased shares on the TSX or NASDAQ was enough to satisfy the reliance requirement for common law misrepresentation claims; and

(b) whether aggregate damages can be assessed against the defendants.

The Other Statutory Requirements

In light of the above, Justice van Rensburg held that certifying the class would serve judicial economy by requiring the parties to bear the cost of litigating complex matters only once without the necessity of multiple proceedings. As such, class proceedings were the preferable procedure for resolving the claims, which were appropriately advanced by the representative plaintiffs.

Having met each of the five requirements for certification, the Court certified the action against IMAX. In light of the Court's assessment of the statutory leave test for secondary market misrepresentation claims, the IMAX decision will most certainly be the subject of further consideration in the coming year.

Deer Creek Energy Ltd. v. Paulson & Co. Inc.

[2009] A.J. No. 923
Alberta Court of Appeal
August 31, 2009

The Court of Appeal upheld the market value approach to share valuation, but concluded that the trial judge erred in ordering cost sanctions against the dissenting shareholders who had sought a higher price for their shares. The Court concluded that dissenting shareholders are entitled to test and challenge the valuation of their shares in the context of take-over transactions.

Facts

Deer Creek Energy Ltd. ("**Deer Creek**") operated and owned a multi-billion dollar oil sands project. To address its limited technical and financial resources, Deer Creek entered into discussions with both Total E & P Canada Ltd. ("**Total**") and Shell Canada Limited ("**Shell**") with an eye to possible joint ventures. Both Total and Shell subsequently attempted to take over Deer Creek, with Total's offer of $31 per share ultimately proving successful. As a result, Total acquired 82.4% of Deer Creek's shares, nominated a new board of directors, and called a special shareholders 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 dissented,

triggering their right to be paid a "fair value" for their shares pursuant to section 191(3) of the *Alberta Business Corporations Act*. The minority complained that Total's $31 offer was too low, despite representing a significant premium over the trading price of Deer Creek's stock at the time. Instead, the minority contended 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 shareholders 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 the amalgamation with Total.

The Valuation Decision

In June 2008, the Alberta Court of Queen's Bench considered the dissenting shareholders' request for a higher price for their Deer Creek shares in the wake of the going-private transaction.

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 stake in Deer Creek, the price of the company's shares had increased, primarily due to Total's 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). The Court held as 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.

While the dissenters had argued that the "discounted cash flow" method was the more appropriate way to value the shares, the Court upheld Deer Creek's application of the "market value" method of share valuation. The Court concluded that the discounted cash flow approach was less appropriate for companies in early stages of development. Because the "net asset value" approach also supported the $31 bid, the Court concluded the offer was fair. Indeed, the fact that almost all of the long-term shareholders of Deer Creek had agreed to the offer only confirmed its fairness.

The trial judge went on to find special circumstances existed such that the dissenting shareholders should be held liable for Deer Creek's costs of the hearing. Specifically, the judge found the dissenting shareholders' excessive claims and the nature of their attack against the Deer Creek board to be grounds for costs sanctions.

Decision of the Alberta Court of Appeal

The dissenting shareholders appealed. While the Court of Appeal upheld the trial judge's decision on the valuation issue, the cost sanctions were overturned. The Court held that the lower Court's approach to valuing Deer Creek's shares was reasonable in the circumstances, as was the trial judge's finding about the effect of the Total takeover on the market as a whole. As such, the Court concluded that it was not precluded from adopting a market value analysis.

With respect to cost sanctions, however, the Court of Appeal ruled that the lower Court erred in finding that special circumstances existed to justify departing from the general rule that dissenting shareholders should not bear the costs of valuation proceedings. The Court ruled that it was not unreasonable for the dissenting shareholders to test and challenge the valuation, nor was there evidence that the dissenting shareholders acted in bad faith.

Neo Material Technologies Inc. (Re)

(2009), OSCB 6941
Ontario Securities Commission
September 1, 2009

The OSC dismissed an application to remove a target company's shareholder rights plan so that a hostile take-over could proceed. The plan, which had received significant shareholder approval, had been adopted shortly after the take-over bid was announced. In an apparent departure from previous practice, the OSC concluded that the board was entitled to use such a tactic if doing so was in the best interests of the target corporation and its shareholders.

Facts

Neo Material Technologies Inc. ("**Neo**"), a Canadian mining and resources company, was the subject of an unsolicited hostile bid in February 2009. The bid was launched by Pala Investments Holdings Limited ("**Pala**") and 0833824 B.C. Ltd. ("**083**"), who together already held approximately 20% of Neo's outstanding shares. Pala initially sought to acquire an additional 20% of Neo's shares, but ultimately sought to acquire a further 9.5% of the outstanding shares at a price of $1.70 per share (the "**Pala Offer**").

Neo's shareholders had previously approved a shareholder rights plan outlining the requirements for any bid for Neo shares. The Pala Offer was structured to comply with the "permitted bid" provisions of that plan in an attempt to avoid triggering rights under the plan.

In the wake of the Pala Offer, however, Neo's board of directors adopted a second shareholder rights plan. This second plan was designed to prevent both creeping take-overs and the taking of control of Neo by means of partial

bids. As such, the second plan required that any offer to acquire Neo shares be made to all shareholders - for all of their shares - in order to ensure that every shareholder was treated equally and fairly in connection with any take-over bid. Just three days after the Pala Offer was announced, Neo's board of directors adopted the second rights plan. Shortly thereafter, the plan was overwhelmingly approved by a majority of Neo's shareholders.

In response to Neo's tactics, Pala and 083 asked the OSC to use its public interest jurisdiction to cease trade the second Neo shareholder rights plan.

The OSC Decision

Pursuant to its public interest jurisdiction under section 127 of the *Securities Act*, the OSC has broad discretion to cease trade a shareholder rights plan. In considering Pala's application to cease trade Neo's second shareholder rights plan, however, the OSC was mindful of the deference owed to Neo's board of directors. The OSC noted that interference with a decision of a board of directors requires the consideration of a number of factors, including shareholder support for the rights plan, the nature of the bid, and the likelihood that the bid will fail if the rights plan is maintained.

The OSC ultimately refused to cease trade Neo's second shareholder rights plan. In doing so, the OSC noted that the Pala Offer was for less than 100% of Neo's shares and that the second rights plan had been overwhelmingly approved by Neo shareholders.

The OSC noted that the directors of a target company are entitled to take steps that they feel are in the company's long-term best interests, including the adoption of a shareholder rights plan allowing the board to seek alternative value-enhancing transactions in the wake of a proposed take-over. In coming to this conclusion, the OSC relied on the Supreme Court of Canada's decision in *Re BCE Inc*[2]. and deferred to the business judgment of the Neo board, which had decided to avoid an auction. The OSC concluded that the Neo board had undertaken a well-structured evaluation process in response to the Pala Offer and that there was no evidence that adopting the second shareholder rights plan did not serve the best interests of the corporation and its shareholders.

Prior to the OSC's decision, Canadian securities commissions had held that a target company's board of directors could not use a shareholder rights plan to indefinitely block a hostile take-over bid. While shareholder rights plans could allow a target company's board more time to seek out "white knights", the decision to sell a company ultimately belongs to the shareholders. As a result, a shareholder rights plan must be waived at some point to permit shareholders to consider an offer. Concluding that the time had not yet come to remove Neo's

2. [2008] 3 S.C.R. 560

second shareholder rights plan (despite more than 70 days having passed since the offer was originally made), the OSC appears to have departed from the earlier approach (or at least lengthened the amount of time considered appropriate for a plan to continue operating), making the shareholder rights plan a potentially more powerful tool for boards hoping to resist hostile take-over bids in the best interests of the company and its shareholders.

Western Canadian Coal Corp. (Re)

(2009), 32 OSCB 820
Ontario Securities Commission
January 14, 2009

The OSC exempted Western Canadian Coal Corp. ("**Western**") from having to comply with section 5.6 of MI 61-101, which required Western to obtain minority approval for a proposed loan arising in connection with a related party transaction.

Facts

Western is a British Columbia-based company whose shares are listed on the TSX. In 2009, Western entered into an agreement in principle to combine with London-based Cambrian Mining PLC ("**Cambrian**") pursuant to the *UK Companies Act*. At the time, Cambrian was Western's largest shareholder, holding approximately 34% of Western's shares. Two Cambrian directors also sat on the board at Western. Only one other shareholder, Audley European Opportunities Fund Limited ("**Audley**") held more than 10% of Western's shares. Audley was also the largest shareholder of Cambrian, holding approximately 25% of that company's shares.

Under the proposed arrangement, Western would acquire 100% of Cambrian's shares by issuing 0.75 Western shares for each Cambrian share. However, Cambrian's wholly owned subsidiary, Cambrian Investment Holdings Limited ("**CI**"), was indebted to Investec Bank (UK) Limited in the amount of US$35,000,000 under a US$50,000,000 Revolving Credit and Term Loan Facilities Agreement (the "**Investec Facility**"). The Investec Facility was secured by, among other things, Cambrian's shares in Western, and was due and payable on January 21, 2009. Cambrian advised Western that it did not have the financial resources to repay the Investec Facility.

Western proposed to loan Cambrian US$36,000,000 (the "**Loan**"), to be transferred to CI for the purpose of satisfying CI's obligations under the Investec Facility. The Loan was to be repaid within 90 days of the conclusion of Western's combination with Cambrian and was to be secured by a first-ranking security interest in all of Cambrian's assets. To do this, however, Western first required the OSC to issue an order exempting Western from section 5.6 of MI 61-101,

Protection of Minority Security Holders in Special Transactions, which required Western to obtain a valuation and minority approval for both the Loan and the broader combination with Cambrian. While Western would typically have been exempted from MI 61-101 given that the Loan, standing alone, represented less than 25% of Western's market capitalization of CDN$213,910,253, minority approval was required because the deal with Cambrian was a related party transaction.

Cambrian advised that it would not be able to proceed with the combination unless the Loan was provided on or before January 21, 2009, because the Investec Facility had to be repaid as soon as the combination proceeded. While Western was taking steps to comply with MI 61-101 with respect to the combination, seeking minority approval of the Loan would result in Cambrian having to find alternative ways to deal with the Investec Facility. This would both prevent the combination from proceeding and deprive Western shareholders the opportunity to vote on the deal with Cambrian.

Decision

The Director held that granting the exemption would not be prejudicial to the public interest. As a result, the OSC exempted Western from having to obtain minority approval in respect of the Loan, on the condition that if minority approval were not obtained for the broader combination with Cambrian, the Loan would be repaid within 90 days.

Certicom Corp. v. Research In Motion Ltd.

94 O.R. (3d) 511 (Ont. S.C.J.)
Ontario Superior Court of Justice
January 19, 2009

The Court blocked Research In Motion Limited ("**RIM**") from advancing a hostile take-over of Certicom Corp. ("**Certicom**"). In preparing its take-over bid, RIM had used certain confidential financial information obtained from Certicom pursuant to two earlier non-disclosure agreements. In light of the agreements, the Court held that RIM was prevented from using Certicom's confidential financial information to launch a hostile bid.

Facts

In February 2007, RIM and Certicom entered into discussions about the possibility of a friendly take-over of Certicom by RIM. During those discussions, the parties signed a Non-Disclosure Agreement (the "**2007 NDA**"). The purpose of the exchange of information contemplated by the 2007 NDA included "assessing the desirability or viability of establishing or furthering a business or contractual relationship between the parties which

may include, without limitation, some form of business combination between the parties." Following the execution of the agreement, Certicom provided RIM with confidential information relating to its fiscal year 2008, as well as details about the company's patent licence agreements, ongoing litigation, and revenue breakdown.

In June 2008, Certicom and RIM executed a second Non-Disclosure Agreement (the "**2008 NDA**"). Unlike the 2007 NDA, the 2008 NDA did not contemplate "some form of a business combination between the parties". Shortly after signing the 2008 NDA, RIM, through its wholly owned subsidiary, Research In Motion Acquisition Corporation Inc. ("**RIMAC**"), circulated a hostile offer to take over Certicom. Certicom's board of directors recommended the rejection of RIM's offer and launched an auction in response. Certicom also brought a motion seeking to block RIM and RIMAC from using Certicom's confidential information in their take-over attempt.

Decision

The Court determined that RIM's use of Certicom's confidential information to assess the feasibility of a hostile take-over bid was a breach under both Non-Disclosure Agreements. RIM and RIMAC argued that a takeover bid constituted a "business combination" as contemplated by the 2007 NDA, thereby permitting the use of Certicom's confidential information for bid purposes. However, the Court did not agree that a hostile bid was a combination *between* the parties. In light of the ordinary and usual meaning of the word "between", the Court concluded that a takeover bid would only amount to a "business combination" between the parties if Certicom had consented to RIM's bid. The Court found support for this position in the fact that the parties had originally contemplated a friendly bid for Certicom when the 2007 NDA was negotiated.

The Court also found that RIM was prevented from using the information obtained under the 2008 NDA. The Court noted that the 2008 NDA differed from the 2007 NDA in two important ways. First, there was no standstill provision. Second, the defined "purpose" of the 2008 NDA did not include reference to a business combination between the parties. Because a modification of the 2008 NDA to allow for a business combination would require Certicom's written consent pursuant to the NDA's entire agreement provisions, the Court concluded that RIM and RIMAC were blocked from using Certicom's information to advance a takeover bid.

The Court granted the permanent injunction requested by Certicom. As a result, RIM and RIMAC were prohibited from pursuing a hostile take-over bid using Certicom's confidential information. The Court noted, however, that RIM was free to either make a friendly bid or to launch a second hostile bid without breaching the NDAs.

Lucero v. ID Biomedical Corp.

2009 BCCA 49
British Columbia Court of Appeal
February 5, 2009

A British Columbia Court dismissed an action brought by warrant holders who had sold their warrants in a company that was the subject of a takeover. The plaintiffs claimed that they suffered damages as a result of selling their warrants for a lower price than the price that was ultimately approved by the Court. The plaintiffs alleged that the company concealed an informal committee's challenge to the valuation of the warrants, which would have caused the plaintiffs not to sell their warrants. In rejecting the claim, the Court refused to extend a fiduciary duty as applicable to the corporation's warrant holders. The B.C. Court of Appeal agreed.

Facts

The plaintiffs held warrants entitling them to purchase stock in ID Biomedical Corporation ("**IDB**"), a publicly traded company specializing in influenza vaccine products. In late 2005, IDB was the subject of a takeover bid by the pharmaceutical company GlaxoSmithKline Inc. ("**GSK**"). Pursuant to the bid, IDB would become a wholly owned subsidiary of GSK, who would acquire all of IDB's outstanding shares and warrants through a Plan of Arrangement process under the *British Columbia Business Corporations Act*. GSK would pay US$35 for each common share of IDB and CDN$5.33 for each warrant.

While there had never been a dispute over the price GSK offered for IDB's stock, a dispute did arise over the value of the outstanding warrants. Having obtained their own expert valuation that deemed the warrants to be worth CDN$10.57 each, an informal committee of IDB warrant holders challenged the value outlined in the Plan of Arrangement.

In order to answer the informal committee's opposition to the valuation, IDB adjourned the court hearing for approval of the Plan of Arrangement. IDB's press release announcing the delay, however, provided no information as to the reasons for the adjournment, and made no mention of the challenge to the warrant valuation.

The Court ultimately approved GSK's acquisition of the warrants for a higher price than that initially offered by GSK, namely CDN$9.20. By that time, however, the plaintiffs had already sold their warrants for a price lower than that ultimately approved by the Court.

The Claim

The plaintiffs sought to recover the difference between the lower price for which they sold their warrants and the higher price approved by the Court. The claim

alleged that IDB made certain negligent misrepresentations by not disclosing the reasons for the initial court delay, namely the challenge to the warrant valuation. The plaintiffs claimed that had they known of the existence of the informal committee and its challenge to the valuation, they would not have sold their warrants when they did. Consequently, they would have benefited from the increased price for the warrants set by the Court. The plaintiffs also alleged that IDB owed its warrant holders a fiduciary duty, which the company breached.

The Trial Decision

The trial judge dismissed the plaintiffs' claim that IDB breached its fiduciary duty to its warrant holders. The Court noted that there was no judicial authority for the proposition that a corporation owes a fiduciary duty to its shareholders. There is no "special relationship" between IDB and its shareholders to warrant the imposition of such a duty.

In any event, the Court noted that even if corporations were in a fiduciary relationship with their shareholders, there was no basis to extend the fiduciary principle so far as to find a duty is owed to a person whose only connection to the corporation is a contractual right to become a shareholder at some point in the future.

With respect to the negligent misrepresentation claims, the Court concluded that the plaintiffs had not relied on IDB's representations in the manner required by the law to give rise to liability. The plaintiffs were sophisticated investors who relied on their financial and legal advisors, rather than IDB's press release. One of the plaintiffs, Mr. Morse, relied simply on his own judgment and sold his warrants as soon as the plan of arrangement had been approved (and after the bidding war he had been hoping for failed to materialize).

As a result, the Court dismissed the entire claim. The plaintiffs appealed.

The Court of Appeal Decision

The Court of Appeal refused to overturn the trial decision, concluding that the judge made certain key findings of fact (with respect to IDB's alleged misrepresentation) that could not be disturbed absent a palpable and overriding error. Justice Ryan, for the Court, held that upon a review of the material before the trial judge, no error of fact or law could be found. Accordingly, the appeal was dismissed.

Nortel Networks Corp. (Re)

2009 ONCA 833
Ontario Court of Appeal
November 26, 2009

Facts

On January 14, 2009, the Nortel group of companies ("**Nortel**") was granted protection from its creditors under the *Companies Creditors Arrangement Act* (the "***CCAA***"). Among other things, the Order granting Nortel *CCAA* protection (the "**Initial Order**") included a suspension of all rights and remedies against Nortel.

On April 21, 2009, both CAW-Canada (the "**Union**") and a group of former Nortel employees (the "**Former Employees**") brought motions for directions seeking certain relief from the effects of the Initial Order. In particular, the Union sought an Order directing Nortel to resume periodic payments to Former Employees despite the Initial Order. The Union also asked the Court to vary the Initial Order to require Nortel to pay termination pay, severance pay, vacation pay, and continued benefits to Former Employees. Payment of certain pension benefits and retirement allowances was also sought. The Union sought relief after Nortel, under *CCAA* protection, ceased payments otherwise required by the collective agreement with the Union. The Union contended that all of Nortel's payment obligations should continue despite Nortel's *CCAA* restructuring - including those to the Former Employees - because Nortel's obligations under the collective agreement could not be separated.

On June 18, 2009, the Court denied the motions. Both parties appealed.

The Union Appeal

The Court dismissed the Union's appeal. According to the Court, the periodic payments at issue were not payments of the type that could be excluded from the Initial Order. Instead, section 11.3(a) of the *CCAA* provided that only payments for services provided to Nortel by its continuing employees could be excluded from the *CCAA* suspension.

Because the periodic payments demanded by the Union were payments for *past* services (rather than for services *currently* being provided), the Court concluded that the payments were essentially "deferred compensation" under the collective agreements. As such, the payments properly fell within the scope of the suspension in the Initial Order.

The Former Employees' Appeal

In an effort to ensure that a company is given the opportunity to carry on business on a pay-as-you-go basis during restructuring, subsection 11.3(a) of

the *CCAA* exempts from the general stay any payments for goods and services provided after the Initial Order. The Court noted, however, that there is no exception which would allow for statutory termination and severance pay to be paid after restructuring begins. In the absence of specific protection from the stay, the Court concluded that it was Parliament's intention to include severance and termination pay in the stay, to avoid frustrating a company's attempt to restructure for the benefit of all stakeholders.

The Court ultimately determined that the motion judge properly exercised his discretion to impose a stay that extended to severance and termination payments to former Nortel employees. This was particularly so in light of Nortel's financial position. In particular, the Court noted that the *CCAA* proceeding was still at an early stage and that the employees had neither statutory priority nor secured claims. The motion judge clearly felt that a stay was necessary in the circumstances. The Court of Appeal saw no error in that conclusion, ultimately dismissing the appeal.

Eddie Bauer of Canada Inc. (Re)

[2009] O.J. No. 3784
Ontario Superior Court of Justice (Commercial List)
July 30, 2009

The Court approved a deal arising from a Stalking Horse process that had been initiated by both the U.S. and Ontario Courts in connection with a cross-border restructuring.

Facts

In June 2009, the Eddie Bauer group of companies (the "**EB Group**"), whose branded products are sold in retail stores and outlets throughout Canada and the United States, sought Chapter 11 bankruptcy protection in the United States. At the same time, the EB Group's Canadian subsidiaries were granted protection under the *Companies' Creditors Arrangement Act* (the "***CCAA***"). Both the U.S. Court and the Ontario Superior Court of Justice approved a cross-border protocol to deal with EB Group's restructuring. At a joint hearing, both Courts approved a Stalking Horse process.

Shortly thereafter, Everest Holdings LLC ("**Everest**") concluded an asset purchase agreement with the parent company of the EB Group. The Everest bid was worth US$286 million and was for substantially all of the assets, property and undertaking of the EB Group. Under the deal, the EB Group's Canadian real property leases would be assigned to Everest, who would in turn offer employment to EB Group's Canadian employees, assume all Canadian locations and at least 250 U.S. retail locations, and assume all other ordinary course liabilities. Because the value allocated to the Canadian assets - $11

million US - exceeded the net value of those assets on a liquidation basis, Everest's bid for the EB Group was deemed to be the best offer.

EB Group subsequently made an application to the Ontario Superior Court of Justice for the approval of the sale and a vesting order with respect to the asset purchase agreement.

Decision of the Ontario Superior Court of Justice

The Court allowed the application, noting that both the process and result were fair and reasonable. Making reference to what have become known as the *Soundair* principles, the Court concluded that the court-appointed receiver had satisfied its duties of applying its business judgment in a manner that took into account the interests of all parties and ensured the efficacy, integrity and fairness in the restructuring process. Noting that the orderly transfer contemplated by the process would protect the value of the goodwill in the 'Eddie Bauer' name, the Court granted the orders sought.

Allen v. Aspen Group Resources Corp.

[2009] O.J. No. 5213
Ontario Superior Court of Justice
December 4, 2009

The Court certified a class action relating to various misrepresentations allegedly made by the directors, officers, auditors and lawyers of Aspen Group Resources Corporation ("**Aspen**") in a take-over bid circular. Aspen had successfully taken over Endeavour Resources Inc. ("**Endeavour**"). The plaintiff Mr. Allen, an Endeavour shareholder and one of its former directors prior to the takeover by Aspen, alleged that Aspen had failed to disclose certain material facts in its bid circular, including a pre-existing obligation to issue additional shares that would dilute the value of the company. The plaintiff also contended that Aspen's financial statements understated certain depreciation and depletion costs, which ultimately resulted in a $4.5 million write-down. The plaintiff claimed these misrepresentations ultimately led to a significantly diminished share price for Aspen securities. While it rejected the claim for rescission, the Court ultimately certified the class action for damages.

Facts

Endeavour was a Calgary-based oil and gas exploration company. In May 2001, Endeavour became the target of a take-over bid by Oklahoma-based Aspen, whose Canadian arm, based in the Yukon, was in the business of acquiring, exploring, developing and operating oil and gas properties throughout North America. In October 2001, Aspen and Endeavour entered into a pre-acquisition agreement, which contemplated that a take-over bid would be prepared in accordance with Ontario's *Securities Act*.

In November 2001, Aspen distributed a take-over bid circular (the "**Circular**") to all Endeavour shareholders. The Circular included Aspen's consolidated financial statements and an independent auditors' report prepared by Lane Gorman Trubitt LLP (the "**Auditors**"). Among other things, the Circular noted that Endeavour's board of directors had unanimously determined that the offer was fair to Endeavour's shareholders and had unanimously recommended that the offer be accepted. Also included was a certificate signed by Aspen's officers and directors, stating that both the Circular and the offer had been approved by the Aspen board.

The law firm WeirFoulds LLP ("**WeirFoulds**") acted on behalf of Aspen during the take-over process. Mr. Egan, a Toronto lawyer and a partner at WeirFoulds, advised Aspen concerning the Endeavour take-over. Indeed, Mr. Egan, who had been an Aspen director since 1996, had been providing legal advice to Aspen for over a decade.

The Claim

Mr. Allen owned Endeavour securities before the Aspen take-over. He had previously been a director of Endeavour, but resigned from that position some eight months before the take-over bid. At the time of the take-over, Mr. Allen tendered his common shares and special warrants of Endeavour in exchange for Aspen securities.

Aspen's acquisition of Endeavour was completed in March 2002. In December of that year, Mr. Allen commenced a class action against Aspen and its individual directors and officers in relation to alleged material misrepresentations made by Aspen in the Circular. Mr. Allen's proposed action was brought on behalf of all holders of Endeavour securities whose shares and warrants had been acquired by Aspen. In particular, the plaintiff alleged that the Circular misrepresentated or failed to disclose the following information:

(a) certain violations by Aspen of the pre-acquisition agreement;

(b) improper self-dealings that occurred while the take-over bid offer was open;

(c) Aspen's pre-existing obligation to issue additional shares to a particular director, which would ultimately dilute the value of Aspen's securities;

(d) understated financial statements of Aspen; and

(e) certain legal actions commenced against Aspen before or during the period that the take-over bid offer was open.

After the take-over, the above information became public. As a result, Mr. Allen contended, Aspen's share price was diminished between the closing of the take-over (in January 2002) and the time the market had absorbed the full

impacts of the disclosure of alleged misrepresentations (by December 2002). The plaintiff asserted that Aspen's share price had seen a net loss of 50 cents per share (from 60 cents to 10 cents) during that period.

Accordingly, Mr. Allen's action claimed that Aspen and its individual directors and officers were liable for damages pursuant to section 131(1) of the *Securities Act*. Mr. Allen also alleged that the Auditors were liable for having signed the certificate in the Circular relating to financial disclosure. Similarly, the plaintiff also alleged that Mr. Egan was liable, both in his capacity as a director of Aspen and for negligence in his capacity as the company's legal advisor. Further, the Plaintiff claimed that WeirFoulds was vicariously liable because Mr. Egan had been acting in the ordinary course of the business of the firm, both in his capacity as a director of Aspen and in his work in the preparation of the take-over bid documentation. In addition to his claim for damages, the plaintiff sought recission.

Decision

In deciding whether the plaintiff's action could proceed as a class action, the Court reviewed the five requirements for certifying class actions as outlined in section 5(1) of Ontario's *Class Proceedings Act*, 1992 (the "***CPA***"), namely:

1. the pleadings disclose a cause of action;
2. there is an identifiable class of two or more persons that would be represented by the representative plaintiff;
3. the claims of the class members raise common issues;
4. a class proceeding would be the preferable procedure for the resolution of those common issues; and
5. there is a representative plaintiff who,
   (a) would fairly and adequately represent the interests of the class;
   (b) has produced a plan for the proceeding that sets out a workable method of advancing the proceeding on behalf of the class and of notifying class members of the proceeding; and
   (c) does not have, on the common issues for the class, an interest in conflict with the interests of other class members.

The proposed action passed the first branch of the test. The Court concluded that the pleadings disclosed reasonable causes of action, with the exception of the claims for rescission, which were clearly statute-barred as a result of the expiration of the limitation period outlined in section 138 of the *Securities Act*. With respect to the plaintiff's claims for damages, however, the Court concluded that the claims met the requisite standard, including the claim

against WeirFoulds. The Court found that because it was not plain, obvious and beyond doubt that those claims could not succeed, they were to be certified.

In respect to the second branch of the certification test, the Court held that the proposed class definition met all the requirements of being clear, objectively defined, reasonable in scope and rationally connected to the common issues of the class action. In particular, the Court felt that there was no issue of extraterritoriality, either with regard to the Court's jurisdiction or with regard to the application of Ontario securities legislation to out-of-province shareholders. This was because the out-of-province shareholders had, through a choice of law clause in the take-over bid agreement, agreed to the application of Ontario law to their claims.

The Court also held that, aside from the claim for rescission, the common issues met the requirements for certification under section 5(1)(c) of the *CPA*. The proposed issues met the test of being substantial ingredients of each class members' claim whose resolution was necessary to resolve each claim.

The Court held that section 5(1)(d) of the *CPA* was also satisfied, as a class action would be a fair, efficient and manageable method of advancing the claims. The Court noted that many members of the class would be smaller shareholders for whom individual actions would be impractical such that a class action would facilitate their access to justice. Further, a class action, coupled with the statutory remedy in section 131 of the *Securities Act*, would achieve the policy goal of "behaviour modification" by holding corporations, their officers, directors and advisors accountable for representations made in take-over bid circulars.

Finally, the Court concluded that the fifth requirement of the test had been satisfied, as Mr. Allen was a suitable representative plaintiff. Interestingly, the Court noted that Mr. Allen was not required to establish an ability to satisfy a potential and entirely hypothetical costs award as a condition of certification.

Since each requirement of the *CPA* had been satisfied, the action was certified as a class action and allowed to proceed to trial. It remains to be seen whether the action will proceed to trial or if a settlement will be reached. The certification of the claim against WeirFoulds as potentially bearing liability for a partner's activities as a director of a private corporation has garnered attention. It will be interesting to see how a trial judge would address this claim, should the matter proceed.

Research In Motion Ltd. (Re)

(2009), 32 OSCB 1421[3]
Ontario Securities Commission
January 27, 2009

The Allegations

The OSC commenced a proceeding against RIM and various of its directors and officers regarding allegations of backdating of stock options ("**Options**") and misleading disclosure concerning the granting of those Options.

The OSC alleged that the company's Options granting practices over a ten year period were inconsistent with the company's stock option plan and public disclosure. The terms of the plan required Options to be priced "at the money" such that the exercise price per share was to be the closing price on the last trading day immediately before the date of the grant. According to the OSC, the officers were involved in granting Options where the exercise price was less than the closing market price on the day immediately before the date of the grant. The OSC also alleged that the company had made misleading disclosure in prospectuses, filings, and financial statements that the Options were priced at fair market value of RIM common shares as at the date of each grant, and that the stock option plan was complied with in granting the Options.

The Settlements

Settlements were reached with the company and the individual respondents, and those settlements were approved by the Commission. Of particular interest were the settlements reached between the OSC and individual RIM officers who were named as respondents.

The Co-CEO and Chairman of the company agreed to pay an administrative penalty of $5 million as well as $700,000 to the OSC for costs. He was also reprimanded by the OSC. In addition to the settlement terms, the Co-CEO and Chairman gave various undertakings to the OSC, including undertaking not to act as a director of any reporting issuer until the later of (a) twelve months from the date of the approval order, and (b) the company's compliance with a certain requirement in the settlement agreement.

The Co-CEO and President of the company agreed to pay an administrative penalty of $1.5 million, plus $150,000 to the OSC for costs; and was reprimanded by the OSC. He also undertook to complete an OSC Staff-approved course regarding the duties of directors and officers of public companies within twelve months from the date of the settlement approval order.

The CFO was prohibited from becoming or acting as a director or officer of any

3. See also Statement of Allegations of Staff of the Ontario Securities Commission dated February 3, 2009.

reporting issuer until the later of (a) five years from the date of the settlement approval order, and (b) the date he completed an OSC Staff-approved course regarding the duties of directors and officers of public companies. He agreed to pay an administrative penalty of $1.5 million plus $150,000 for costs, and was reprimanded by the OSC.

The VP, Finance was prohibited from becoming or acting as a director or officer of any reporting issuer until he had completed an OSC Staff-approved course regarding the duties of directors and officers of public companies. He agreed to pay $50,000 to the OSC for costs and was reprimanded by the OSC.

Individual Undertakings

In addition to their agreement to the settlements, the officers also gave financial undertakings to the OSC. For example, while the Options granting practices largely "benefited Directors and employees across all levels at RIM" who were not before the OSC, the individual respondents undertook to repay those amounts in addition to their repayment with interest of the benefits each personally received as a result of the Options granting practices. The chief officers would contribute $38.3 million to the company in respect of the outstanding benefit arising from incorrectly priced Options granted to all employees from 1996 to 2006; and $44.8 million (reduced by $15 million to credit amounts already paid by the co-CEOs towards costs) to the company to defray any costs it had incurred to investigate and correct any improper Options granting practices.

ABCP Settlements Reached Following a Joint Investigation

On December 21, 2009, Quebec's *Autorite des marches financiers* ("**AMF**"), the OSC, and the Investment Industry Regulatory Organization of Canada ("**IIROC**") reached settlements in connection with the Canadian asset-backed commercial paper ("**ABCP**") market. In total, the settlements provided for the payment of $138.8 million in administrative penalties and investigation costs.

Background

ABCP is a financial instrument primarily used as a form of short-term investment that usually yields 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 that 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.

Ultimately, a group of 17 financial and investment institutions put forward a market-wide Plan of Compromise (the "**Plan**") pursuant to the *CCAA*. 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. The Plan was ultimately approved by 96% of noteholders. The Ontario Superior Court of Justice sanctioned the Plan in June 2008. The decision was upheld by the Court of Appeal, with the Supreme Court of Canada denying leave for a further appeal.

The Settlements

In the wake of the ABCP market freeze, the AMF, OSC and IIROC worked together to respond to the regulatory issues arising from ABCP.

In December 2009, settlements were reached between the regulators and those seven institutions involved in the Canadian third party ABCP market. Five of the institutions had allegedly failed to adequately respond to third party issues in the ABCP market. In particular, these institutions continued to buy and/ or sell ABCP without complying with relevant processes for addressing third party issues. As a result, the institutions were required to pay $138.8 million in administrative penalties and investigation costs, which would ultimately be used in the public interest. The sanctions also focused on compliance, requiring each institution to have an independent compliance review or verification by an outside consultant of their fixed income departments.

The OSC and IIROC have begun disciplinary hearings against two additional institutions related to the ABCP matter.

II. NON-CANADIAN CASES

Bluebrook Ltd. (Re)

[2009] EWHC 2114
England and Wales High Court (Chancery Division)
August 11, 2009

Bluebrook Limited ("**Bluebrook**") sought the Court's approval of three schemes of arrangement under the U.K. *Companies Act 2006*. A group of subordinated creditors challenged Bluebrook's valuation, which showed that it was only able to satisfy its debts to other secured creditors. The Court rejected the challenge to the schemes, concluding that the subordinated lenders' legal rights were not affected.

The Facts

Bluebrook is the holding company for the largest car wash group of companies in the world. Bluebrook had borrowed £315 million (the "**Senior Debt**") from a group of senior lenders (the "**Senior Lenders**"). Bluebrook's indirect subsidiary, Spirecove, also borrowed about £120 million from another lending group (the "**Mezzanine Lenders**"). Both the Senior Lenders and the Mezzanine Lenders took security. Various arrangements had the effect of subordinating the Mezzanine Lenders' interests to that of the Senior Lenders.

Bluebrook and Spirecove soon ran into severe financial difficulties which rendered both companies unable to repay the interest due to both the Senior Lenders and the Mezzanine Lenders. While individual companies in the Bluebrook group of companies were able to pay their debts as they fell due, their trading prospects were not good. The value of the Bluebrook group of companies was less than the Senior Debt. When credit insurance was withdrawn and difficulties with suppliers emerged, Bluebrook began restructuring negotiations with its creditors.

The Proposed Restructuring

Bluebrook proposed a debt-for-equity swap in favour of the Senior Lenders. The proposed restructuring would involve the creation of three new companies that would inherit all of Bluebrook's assets and most of the Senior Debt. About £12 million of the Senior Debt would remain with the old group of companies in order to enable the Senior Lenders to benefit from any unexpected asset realizations. Otherwise, the Senior Lenders would obtain the majority of the equity in the new group.

Under the scheme, however, there would be no assets available in the old group of companies to pay the Mezzanine Lenders. The Mezzanine Lender would receive no rights over the new group of companies, given that they had

no interest in the group in light of the size of the Senior Debt and the Mezzanine Lenders' subordinated rights. The new scheme companies maintained that they were free to choose those creditors with which they would enter into schemes of arrangement. As a result, the new companies consciously chose to compromise only with the Senior Lenders.

The Claim

The Mezzanine Lenders claimed that the proposed arrangements would bar them from any prospect of benefiting from Bluebrook's assets. In particular, the Mezzanine Lenders alleged that there remained a possibility that Bluebrook's assets would have an economic value that was higher than that presented by Bluebrook and the Senior Lenders. Taking issue with that valuation, the Mezzanine Lenders went before the Court to prevent the proposed schemes.

The Bluebrook Valuation

The new companies under the schemes of arrangement obtained a valuation report using the following methodologies:

1. An "Income Approach" based on the cash flow that the business was expected to generate in the future. They used an "alpha factor" to account for fluctuations in the market, which ultimately depressed the valuation amount;

2. A "Market Approach" using publicly traded companies as a benchmark and an analysis of statistics derived from transactions in the industry to value the business; and

3. A "Leveraged Buy-Out Analysis" using a hypothetical potential private equity purchaser to calculate a hypothetical offer for the group.

All three methodologies valued the companies on a going concern basis, assuming zero growth in the last year or making assumptions as to the weighted average cost of capital.

Because each of the methodologies showed the value of the Bluebrook group to be less than the £315 million Senior Debt, the new companies claimed the Mezzanine Lenders had no genuine economic interest in the group. One valuation estimated that a purchaser would pay roughly £265 million for the business. An additional valuation found the Bluebrook group to be worth only £164 million on a restricted sales basis (a swift sale without a full marketing campaign) and £208 million on a full market value basis.

Based on this information, Bluebrook's directors initiated a third party sales process, which produced an offer that valued the business at between £150 million to £188 million on a cash and debt free basis. The board of directors rejected the offer.

The Mezzanine Lenders initially failed to provide their own valuation evidence. During the proceedings before the Court, however, the Mezzanine Lenders produced a report relying on the "Monte Carlo Simulation," a computer simulation involving repeated calculations using random assumptions. The report attacked the valuations provided by the Senior Lenders because the market price valuation was supposedly artificial (since there was no market for the assets). The Mezzanine Lenders' report also noted that market conditions would have deterred any bids and that one of the valuation methods suffered from the absence of proper comparables. The Monte Carlo Simulation figures offered by the Mezzanine Lenders concluded that the value of the Bluebrook group was often in excess of £320 million and therefore higher than the Senior Debt. As a result, the Mezzanine Lenders argued that the fairest option would be to allow the Senior Lenders the first right to have their debt repaid without absorbing all the equity in the business (and therefore leaving potential room for the Mezzanine Lenders to benefit from the assets).

The Decision

The Court, which was critical of the Mezzanine Lenders' report (particularly for its lateness and its methodology), concluded that the Mezzanine Lenders had no grounds to object to the proposed schemes. In particular, the Court noted that the Monte Carlo Simulation approach was more appropriate for specialized industries where earnings are uncertain such as the pharmaceutical industry. The Court was also highly critical of the report's conclusion that Bluebrook's business was "extremely sound and profitable" in light of the company's failure to pay its interest obligations and its balance sheets showing insolvency.

The Court also rejected the Mezzanine Lenders' claims of prejudice under the proposed schemes. In particular, it noted that the Mezzanine Lenders had a right under an inter-creditor agreement to buy out the Senior Lenders and to manage Bluebrook's restructuring themselves, if the Mezzanine Lenders were truly concerned about assets being sold under value.

Finally, the Court rejected the claims that Bluebrook's directors breached their fiduciary duties to the companies and its creditors. The plaintiffs had suggested that discharging the duty to creditors meant that Bluebrook's directors should have bargained with the Senior Lenders to ensure at least something was provided to the Mezzanine Lenders. The Court noted, however, the directors had no real bargaining position in this case, as the company was technically insolvent and debt was growing. The Court specifically rejected the suggestion by the Mezzanine Lenders' counsel that Bluebrook's directors should have threatened to carry on trading, as doing so would have constituted wrongful trading in light of the companies' inability to repay their debts.

According to the Court, the Bluebrook group's financial position was such

that its only options were a successful restructuring or formal insolvency. A going concern basis was an appropriate methodology, unlike the Mezzanine Lenders' valuation, which lacked "real world judgments about what is likely to happen." The Court ultimately concluded that the value of the Bluebrook group of companies was less than the Senior Debt on a going concern basis and that the Mezzanine Lenders could have no economic interest. As a result, there was no reason to prevent the schemes from proceeding.

Ryan v. Lyondell Chemical Company, et al.

C.A. No. 3176-VCN
Delaware Court of Chancery
August 29, 2008

During a motion for summary judgment in a shareholder class action, the Delaware Supreme Court reaffirmed director exculpation provisions in the context of corporate merger transactions.

Facts

The plaintiff, Walter E. Ryan, Jr. ("**Ryan**"), challenged a $13 billion cash-for-shares merger transaction (the "**Merger**") between Basell AF ("**Basell**") and Lyondell Chemical Company ("**Lyondell**"). Lyondell had previously been the third-largest independent public chemicals company. Basell, also in the chemicals business, was based in Luxembourg. Leading up to the time of the Merger, Lyondell was a strong and financially viable company that was neither looking to raise capital nor to spin off any of its divisions. As a result, Basell's repeated expressions of interest in acquiring Lyondell had been previously rebuffed by Lyondell's board of directors (the "**Board**") for over two years.

In May 2007, Basell informed the market and the Securities and Exchange Commission of its potential interest in a merger with Lyondell. Upon hearing about Basell's interest, the Board opted to wait and see what would happen next. After the announcement failed to arouse competing bids, the CEOs of both Lyondell and Basell held a series of calls and meetings to discuss a potential deal.

Basell's first proposal of a $40 per share all-cash deal was rejected, as was its follow-up offer. Finally, Basell offered Lyondell shareholders $48 per share in cash for a merger. The offer was conditional upon Lyondell's agreement to a $400 million break-up fee and an executed merger agreement within a week. Basell's final offer represented a 45% premium over the closing share price on the last trading day before Basell's announcement of its interest in Lyondell.

The Board met to discuss the bid and retained financial advisors. The parties negotiated the terms of a merger agreement, but Basell rejected Lyondell's

attempts to include a higher price, a go-shop provision and a reduced break-up fee in the final transaction. Five days after meeting to consider Basell's proposal, the Board approved the deal. The Merger closed four months later.

The Claim

Ryan commenced a class action against Lyondell's directors, alleging breaches of their fiduciary duties. In particular, Ryan claimed that the Board failed to seek the advice of advisors who could properly value the company. Similarly, the action alleged that the Board failed to conduct a formal pre-signing market check to determine whether a better price could have been obtained. As a result, Ryan asserted that the process undertaken by the Board was so insufficient as to amount to a conscious disregard for the directors' *Revlon* duties of loyalty and good faith. Ryan sought monetary damages.

The Delaware Chancery Court Decision

Lyondell's directors sought summary judgment on the grounds that the company's charter contained a provision absolving the directors from any potential liability for breaches of the duty of care.

Although the Court found that the directors may have breached their *Revlon* duty to seek the best price reasonably available in a sale of the company, the Court also found that a damages claim was barred by the relevant provision of Lyondell's charter. Because the Board appeared independent and disinterested, the Court also rejected most of the duty of loyalty claims. While summary judgment was granted on most of the claims advanced, the Court nevertheless concluded that there was a sufficient issue for trial: whether Lyondell's directors breached their duty of loyalty by failing to act in good faith and disregarding their *Revlon* duties. The Court was unusually pointed in its criticism of the Board's process of selling Lyondell, taking particular issue with the Board's acceptance of the CEO's direction of an unsolicited sale process, the brevity of Board meetings, the failure to conduct a formal market check, and the speed of the sale process. If Lyondell's directors were found to have so fundamentally breached their *Revlon* duties such that they breached their duty of loyalty, the directors could face personal liability.

The Appeal to the Delaware Supreme Court

The Delaware Supreme Court reversed the lower court's decision. The Court concluded that there is no uniform or required set of rules that must be followed by a board in order to meet its fiduciary duty to secure the best price for shareholders. The Court noted that no "court can tell directors exactly how to accomplish that goal, because they will be facing unique combination of circumstances, many of which will be outside their control." As a result, the Supreme Court rejected the lower court's conclusion that the Board violated its

Revlon duties when it failed to conduct an auction or a market check.

The Court also noted that Ryan's claims were merely allegations of the directors' imperfect attempt to carry out their *Revlon* duties. Such imperfect attempts were not enough to amount to a conscious disregard of the *Revlon* duties constituting bad faith. The Court noted that an inquiry into an alleged breach of the duty of loyalty, which is different from a duty of care, requires looking at whether the directors "utterly failed" to attempt to obtain the best sale price. Because the Board took several steps in the week the deal was under consideration, including attempts to negotiate a better price and soliciting the advice of financial and legal advisors, the Court found that there had been no breach of the duty of loyalty. Approving a merger at a "blowout price" that the Board deemed too good not to pass along to shareholders was not in itself a breach of the Board's *Revlon* duties.

Finally, the Court refused to accept the lower court's decision to impose *Revlon* duties on Lyondell's directors from the time of Basell's original announcement up to the commencement of negotiations with Lyondell. Because Lyondell had first adopted a "wait and see" approach and had not yet made a determination to pursue a transaction, *Revlon* duties did not apply. The directors' go-slow approach was an "entirely appropriate" exercise of their business judgment.

With its decision, the Delaware Supreme Court maintained the extremely high bar for successfully bringing a breach of duty of loyalty claim against independent and disinterested corporate directors. Similarly, claims for money damages against directors in the face of exculpatory provisions of the corporate charter were made more difficult as a result of this decision. In such cases, money damages will only be available where directors consciously failed to even attempt to carry out their fiduciary duties. Finally, this decision confirmed that *Revlon* duties only begin when the directors make a determination to pursue a transaction, rather than in any period where a transaction is merely contemplated but awaiting further developments.

In Re NYMEX Shareholder Litigation and Greene v. New York Mercantile Exchange Inc.

C.A. Nos. 3621-VCN and 3835-VCN
Delaware Court of Chancery
September 30, 2009

In two parallel actions, certain shareholders attempted to challenge an already consummated merger. The plaintiffs alleged breaches of the fiduciary duties of loyalty, due care and candour in respect of the transaction. The Court dismissed all the claims in keeping with the approach outlined in the *Lyondell Chemical Co. v. Ryan* decision, reiterating the considerable deference given to an independent board of directors facing a change of control.

The Facts

NYMEX Holdings, Inc., through its subsidiary the New York Mercantile Exchange (collectively, "**NYMEX**"), was the world's largest commodity futures exchange. In mid-2007, the New York Stock Exchange ("**NYSE**") spoke to NYMEX's chairman about potentially purchasing NYMEX for $142 per share; a significant premium over NYMEX's then-trading price. NYSE never followed through with a formal offer, however, because NYMEX's chairman demanded a senior executive position for himself as a precondition to the deal.

In early 2008, NYMEX entered into a confidentiality agreement with CME Group, Inc. ("**CME**") following earlier discussions between CME and NYMEX's chairman and CEO about a potential transaction. After announcing the confidentiality agreement, NYMEX's board approved a change of control plan providing for over $97 million in payments to senior management.

Shortly thereafter, CME offered to buy NYMEX for $119 per share, an 11% premium over the closing price of NYMEX's shares on the last trading day before the announcement. A substantial portion of the consideration for the proposed merger was to be payable in CME stock.

Within a week of the announcement, CME stock dropped from $635 to $485 per share. Interestingly, CME's offer did not contain a "collar" provision that would have protected against fluctuations in the stock price. As a result, the decline in CME stock price resulted in a significant decrease in the merger consideration to approximately $100 per share.

In March 2008, CME and NYMEX announced the merger agreement by which CME would acquire all of NYMEX's common stock for $36 per share in cash and 0.1323 shares of CME stock per NYMEX share. Despite the significant decrease in merger consideration, J.P. Morgan and Merrill Lynch provided a fairness opinion, using a discounted cash flow analysis, favouring the deal. 95% of shareholders approved the merger, which ultimately closed in August 2008.

The Claim

The plaintiffs, owners of NYMEX common stock, brought an action against the directors of NYMEX for alleged breaches of their fiduciary duties of loyalty, due care and candour. The alleged breaches included the NYMEX board's failure to inquire into other potential transactions, its agreement to CME's first and only offer, and the directors' agreement to a hefty change in control plan while an acquisition agreement was imminent. The plaintiffs also alleged that the board agreed to sell NYMEX through an unfair process and at an inadequate price, all while NYMEX's chairman and CEO collected $60 million in severance payments. In particular, the plaintiffs claimed that NYMEX's chairman and CEO

each assured CME that they would not renegotiate any of the economic terms of the deal and rejected CME's offer to include a collar in the final agreement.

In a parallel action, the Class "A" members of the NYMEX Exchange brought an action making similar allegations. These plaintiffs, who owned between 45 and 47 percent of NYMEX common stock, also alleged that the previous waiver of their rights and claims against NYMEX and CME were invalid. As part of the merger with CME, the plaintiffs had previously been offered a $750,000 membership rights payment as compensation for the reduced value of their seats. In exchange, the plaintiffs were required to sign a release waiving their rights and claims against the parties, including their perpetual rights to a percentage of the NYMEX Exchange revenues. The plaintiffs argued both that these rights could not have been waived by a class vote and that the release was coercive.

The Decision

A preliminary issue between the parties was whether the dispute should be considered using either the *Revlon* criteria (relating to directors' duties where a fundamental change of corporate control is contemplated) or under the business judgment rule. While the Court noted that there is no "black-line rule" about what percentage of the merger consideration can be in cash form without triggering *Revlon* duties, the Court concluded that the issue did not need to be dealt with definitively in this case. This was because NYMEX's Certificate of Incorporation contained an exculpatory clause protecting its directors from personal monetary liability for breach of their duty of care.

The plaintiffs further alleged that NYMEX's directors breached their fiduciary duty of loyalty by allowing themselves to be controlled by NYMEX's chairman, thereby acting in bad faith. The Court held, however, that the board's acquiescence to or endorsement of the actions of a senior executive were not enough on their own to support an inference of domination or the absence of directorial will. In keeping with the approach recently outlined in *Lyondell Chemical Co. v. Ryan* (discussed in detail on page 36 above), the Court concluded that the breach of the duty of loyalty must fail in the absence of evidence of the directors' lack of independence or good faith. Because the plaintiffs could only show that the board process for negotiating the merger with CME was "not perfect", their claim could not succeed.

The Court also went on to reject the plaintiffs' remaining claims, including claims that NYMEX's board failed to satisfy its disclosure obligations and individual claims against both the chairman and CEO of NYMEX. The Court also concluded that the Class "A" plaintiffs had no actionable claim against NYMEX directors, as the plaintiffs' super-majority vote in favour of the waiver of their rights was binding.

As a result, both actions failed.

San Antonio Fire & Police Pension Fund v. Amylin Pharmaceuticals Inc., et al.

983 A.2d 304; 2009 Del. Ch. LEXIS 83
Delaware Court of Chancery
May 12, 2009

The Delaware Court of Chancery held that the board of directors of Amylin Pharmaceuticals, Inc. ("**Amylin**") had the power to "approve" a slate of nominees for election to the board for the purposes of a trust indenture agreement while simultaneously recommending and endorsing its own alternative slate of nominees.

Facts

In June 2007, Amylin entered into a trust indenture agreement (the "**Indenture**") for the issuance of 3% convertible senior notes due in 2014 (the "**2007 Notes**"). The Indenture appointed the Bank of New York Mellon Trust Company as trustee (the "**Trustee**"). Section 11.01 of the Indenture provided noteholders the right to demand redemption of their notes at face value if the majority of Amylin's board of directors ceased to be composed of the "continuing directors" or other individuals "approved" by the continuing directors (the "**Continuing Directors Provision**"). The Indenture defined "continuing directors" as those directors in office on the date of the issuance of the notes and any subsequent directors whose election to the board was "approved" by at least a majority of the initial or subsequent directors whose election had been previously approved.

In January 2009, Icahn Partners LP ("**Icahn**"), a stockholder of Amylin, notified Amylin of its intention to nominate a slate of five directors to Amylin's 12-person board. The next day, Eastbourne Capital Management, L.L.C. ("**Eastbourne**"), another stockholder of Amylin, notified Amylin of its intention to nominate its own slate of five directors. While "approving" the competing slates of candidates for the purposes of the Indenture, Amylin's board of directors recommended its own slate of candidates.

The Claim

The plaintiff San Antonio Fire & Police Pension Fund (the "**Fund**") held common stock of Amylin. The Fund filed a class action suit against Amylin, its directors and the Trustee to seek a declaration that Amylin's board had the sole right and power to approve the stockholder nominees for the purpose of the Continuing Directors Provision of the Indenture. Amylin filed a cross-claim against the Trustee's request for the opposite declaration.

The parties disagreed over the meaning of "approve" for the purposes of the Continuing Directors Provision. On one hand, the Fund argued that "approve" meant "giving formal sanction to or to confirm authoritatively". Accordingly,

the Fund - supported by Amylin - believed that the board of directors had the ability to “approve” any nominees proposed by Icahn and Eastbourne, even if the board ultimately preferred its own slate of candidates. The Trustee, on the other hand, contended that “approve” was synonymous with “endorse or recommend,” such that the board could not “approve” of a nominee that it did not also endorse or recommend.

The Partial Settlement

Amylin required that the dispute over the Continuing Directors Provision be resolved in Court before the board could consider the Icahn and Eastbourne nominees. While the Fund initially advanced additional allegations against Amylin and its directors – including claims for breach of fiduciary duty – the parties ultimately came to a partial settlement. Pursuant to the settlement, the Fund dropped the breach of fiduciary duty allegations in exchange for the promise that the board would approve the nominees of Icahn and Eastbourne, subject to the Court’s determination that the board had the power to do so.

The Court’s Decision

Because the Indenture constituted a contract between Amylin and the Trustee, the issue was a question of contract interpretation. Three main issues were before the Court:

1. whether Amylin’s board had the power to “approve” the dissident nominees as “continuing directors” (for the purposes of the Indenture) after it had opposed their election and offered its own slate of nominees;
2. whether approval by Amylin’s board violated the company’s duty of good faith and fair dealing under the Indenture; and
3. whether the board met its duty of care when it approved the Indenture without appreciating the effect of the Continuing Directors Provision.

The Court held that Amylin’s reading of the Indenture was the correct one. Amylin’s board had the power to approve dissident nominees as continuing directors, even where the board opposed their election and advanced its own slate of nominees. The Court held that adopting the Trustee’s alternate interpretation of the Continuing Directors Provision would mean that any contested election of stockholder nominees – even where differences were the result of insubstantial matters – would bar the board from approving a dissident slate. This would ultimately prevent any change in the majority of the board for the entire life of the notes, resulting in an impact on shareholder franchise rights that may be contrary to the board’s fiduciary duties and, in any event, may be unenforceable as being against public policy.

The Court also noted that continuing directors provisions can operate as

improper entrenchment devices coercing stockholders into voting only for persons approved by the existing board. Instead, the Court held that these provisions are properly understood to permit the existing directors to approve any person, whether nominated by the board or a stockholder, so long as the directors provide their approval in keeping with the implied covenant of good faith and fair dealing and in keeping with their typical fiduciary duties.

Having determined that the board had, in the abstract, the power to approve a stockholder-nominated slate of directors while still engaging in a proxy contest against that slate, the Court turned to the question of whether the Amylin board had properly exercised its right to do so in this case. The Court noted that the underlying rule is that the board may approve the stockholder nominees where the board determines in good faith that the election of one or more of the stockholder nominees would not be materially adverse to the interests of the corporation or its stockholders. Given the underdeveloped state of the record, the Court held that this issue should be left to a more complete trial.

Finally, the Court rejected the argument that Amylin's board breached its duty of care when it adopted the Continuing Directors Provision without appreciating its effects. Because the board had sought advice from highly-qualified counsel, investment bankers and Amylin's management, the Board acted properly in approving the issuance of the 2007 Notes under the Indenture.

Certain Regulatory Developments

III. CERTAIN CANADIAN REGULATORY DEVELOPMENTS

Federal Government Proposes Canadian Securities Legislation

On May 26, 2010 the Government of Canada released proposed federal securities legislation which marks a key step towards its commitment to establish a Canadian securities regulator. The proposed legislation would apply as provinces and territories opt in, with the objective of having a single national securities regulator. Concurrent with the release of the proposed legislation, the Government referred the proposed legislation to the Supreme Court of Canada for an opinion on its constitutionality.

Communication by Reporting Issuers with Beneficial Owners of Securities

On April 9, 2010, the Canadian Securities Administrators ("**CSA**") published for comment proposed amendments to National Instrument 54-101 *Communication with Beneficial Shareholders of Securities of a Reporting Issuer*. The proposals, if enacted, will permit reporting issuers to satisfy the delivery requirements for annual meeting materials by posting the materials on a website other than SEDAR which will allow beneficial owners to access materials on-line. The proposals recognize the development of internet communications and will increase the cost efficiency of shareholder communications. The public comment period for the proposal expires on August 31, 2010.

The "notice-and-access" proposals will permit, but not require, reporting issuers to meet their delivery requirements by posting annual meeting materials on a website other than SEDAR. Reporting issuers may choose to continue to deliver such materials by post and beneficial owners will continue to be entitled to receive a paper copy of the materials at the issuers' expense. The notice and access option will not be available in respect of meetings at which special business will be conducted.

New Insider Reporting Regime

A new reporting regime for insiders of Canadian public issuers, reflected in National Instrument 55-104 *Insider Reporting Requirements* and Exemptions and its Companion Policy took effect on April 30, 2010. The key changes introduced in the new regime include:

- The deadline for filing insider trading reports (other than initial reports) will be reduced from 10 calendar days to 5 calendar days. This change

will take effect October 31, 2010.

- The number of insiders required to file insider reports will be reduced to those persons that have access to material undisclosed information regarding the reporting issuer and significant influence over the reporting issuer.
- The stock-based compensation reporting requirements will be simplified and will give issuers the option to file reports on behalf of insiders.

Proposals to Amend Mining Disclosure Rules

On April 23, 2010 the CSA published for comment amendments to National Instrument 43-103 *Standards of Disclosure for Mineral Projects*. The proposed amendments streamline the disclosure requirements, repeal or reduce certain existing disclosure requirements which were difficult to comply with in practice, provide flexibility to accept foreign professional associations or designations and bring the rule up-to-date with changes that have occurred in the mining industry.

The proposed disclosure includes a new form for technical reports which is less prescriptive and more adaptable for advanced stage and producing properties. In addition, the proposed rule will allow an issuer to include a preliminary economic assessment or historical estimate in certain circumstances. In addition, provisions have been included to allow an issuer to delay filing a technical report, to remove certain certification requirements of qualified persons, and to expand the acceptance of foreign professional associations to which qualified persons must belong.

Update on Implementation of International Financial Reporting Standards

On May 21, 2009, the CSA issued Staff Notice 52-324 - *Issues Relating to Changeover to International Financial Reporting Standards*, an update on the changeover to international financial reporting standards ("**IFRS**") in Canada (the "**CSA Notice**"). On February 5, 2010, the OSC published OSC Staff Notice 52-718 *IFRS Transition Disclosure Review* (the "**OSC Notice**") which outlines deficiencies in disclosure reporting issuers have made in respect of their implementation of IFRS. Canadian publicly accountable enterprises will be required to adopt IFRS, the international accounting standards issued by the International Accounting Standards Board, in lieu of Canadian GAAP, for fiscal years beginning on or after January 1, 2011 (the "**Changeover Date**").

The CSA Notice provides an update on:

- adoption of IFRS by domestic issuers for periods beginning prior to the changeover date;
- interim financial statement requirements in the year of IFRS adoption;
- use of references to IFRS and Canadian GAAP; and
- proposed exemptive relief in respect of straddle period financial statements and late initial IFRS filings.

Domestic issuers who wish to prepare their financial statements in accordance with IFRS prior to the changeover date must apply for exemptive relief. Where a domestic issuer has filed interim financial statements in the year that it proposes early adoption of IFRS, such relief will be conditioned on the issuer filing revised IFRS interim financial statements, revised management discussion and analysis, and new interim officer certificates.

The CSA proposes that in the first financial year that an issuer reports using IFRS, such issuer be required to:

- disclose compliance with IAS Standard 34 *International Financial Reporting* (which standard prescribes the contents of, and principles and recognition and measurement for, interim financial reports) in its interim financial statements; and
- file an IFRS-compliant balance sheet as at the issuer's "transition date" in its first interim financial statement, to assist readers in understanding the impact of the changeover to IFRS.

The OSC Notice reflects the results of OSC staff's review of issuers' disclosure relating to IFRS conversion. The OSC Notice stated that approximately 40% of issuers made no IFRS disclosure and of the issuers who made such disclosure, approximately 50% was boiler plate disclosure and not reflective of the particular issuer. The OSC Notice reminds issuers of the disclosure requirements in respect of IFRS implementation which were published by the OSC in May 2008. Such disclosure should discuss the progress of the issuer's IFRS change-over plans and a discussion and analysis of the impact of IFRS on internal controls, financial reporting expertise, accounting policies, disclosure controls and procedures, and information technology.

New Registration Regime

National Instrument 31-103 *Registration Requirements and Exemptions* and Companion Policy 31-103 CP *Registration Requirements and Exemptions* came into effect on September 28, 2009 (the "**Effective Date**") and consolidate,

modernize and largely harmonize registration requirements across Canada (collectively, the "**New Regime**"). The New Regime will affect not only existing registrants but also other entities operating in the capital markets who are not currently registered.

Highlights of the new regime include:

- Requirement to register as a dealer will now be based on a "business trigger" so those persons or companies who are in the "business of trading" in securities must register. The business trigger is a fact-based test. Previously registration was based on a "trade trigger" and exemptions were available depending upon the nature of the trade. For example, trades to accredited investors or minimum purchase amount were exempt.
- The existing trade based registration exemptions such as the accredited investor and minimum purchase amount exemptions have now been removed. Those operating in the exempt market who are in the business of trading in securities must register in the new category of exempt market dealer.
- Investment fund managers are now required to register. An investment fund manager is any person who directs the business and affairs of an investment fund.
- The international dealer and adviser registration categories have been replaced with exemptions. The activities an international dealer may undertake in Canada have been narrowed.
- Registration is now required for chief executive officers and chief compliance officers of registrant firms.
- Enhanced rules on relationship disclosure, referral arrangements, conflicts of interest and investor complaints.

TSX Rules Amended to Require Security Holder Approval of Public Companies by TSX Listed Issuers

On November 24, 2009 the TSX amended its Company Manual to require TSX listed issuers to obtain security-holder approval where they propose to issue securities in connection with the purchase of a public company where the securities to be issued exceed 25% of the TSX listed acquiror's outstanding securities (on a non-diluted basis). Prior to this amendment, the TSX did not require listed issuers to obtain security holder approval where securities were being issued in connection with the acquisition of a public company. The threshold dilution level is now the same for both public and private company acquisitions.

The amendments follow two prior public proposals of the TSX as well as the decision of the OSC in *In the Matter of HudBay Minerals Inc*. (“**HudBay**”). The OSC concluded that in the particular circumstances of that case, the fair treatment of shareholders and the public interest required shareholder approval for the issuance of securities of HudBay in its proposed acquisition of Lundin Mining Corp. which would have resulted in the dilution of HudBay shares of over 100%.

Most major stock exchanges require security holder approval in dilutive transactions, including the acquisition of a public company. The threshold for most US exchanges is 20% and therefore lower than the TSX.

Canadian Securities Regulators Abandon Proposals to Amend 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*. The CSA indicated on November 13, 2009 that as a result of public comments received on the proposals, they do not intend to proceed further with the proposals.

Variation of Take-over Bids

On December 18, 2009 the CSA published CSA Staff Notice 62-305 *Varying the Terms of Take-Over Bids* which outlines CSA staff’s view of negative variations made to a formal take-over bid which result in the bid being “less favourable” to target security holders. Variations identified by the Notice would include lowering the consideration offered, changing the form of consideration, other than to add to the consideration already offered, lowering the proportion of outstanding securities subject to the bid, and adding new conditions to the bid.

One of the fundamental tenets of take-over bid regulation is that offerors make offers on terms they are prepared to offer. The notice addresses staff’s views on negative variations of public offers. The take-over bid regime provides that a bid shall be open for the prescribed 35 day period and securities are to be taken up and paid for at the bid price if the conditions of the bid have been satisfied or waived.

The notice states that it is staff’s view that the take-over bid regime does not contemplate the unilateral “withdrawal” of a bid, or, if all the terms and conditions

have been satisfied or waived, a reduction in the price or introduction of new conditions. CSA staff indicate that they will be prepared to challenge negative variations and will consider whether the variation is in response to a failure of a bona fide condition of the offer, is effected as an alternative to allowing the bid to expire unsuccessfully, provides procedural protections to offeree security holders, and would not be abusive to security-holders.

IV. CERTAIN U.S. REGULATORY DEVELOPMENTS

No More Sarbanes-Oxley Exemptions for Small Companies

Following the implementation of the Sarbanes-Oxley Act's internal control provisions in 2003[4], smaller public companies have been granted repeated extensions with respect to certain compliance obligations that were felt to be too onerous. The last of these extensions will expire this year.

Section 404 of the Sarbanes Oxley Act[5] (the "**Act**") requires, in part (a), that each annual report of an issuer contain "an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting." Part (b) of Section 404 requires "each registered public accounting firm that prepares or issues the audit report for the issuer" to "attest to, and report on, the assessment made by the management of the issuer" under part (a).

Reporting under part (a) of Section 404 has been required of all issuers since fiscal years ending after December 15, 2007, but part (b) attestations have not previously been required of non-accelerated filers[6]. The SEC has extended the latter deadline due to what was perceived as the high cost of compliance. While lower in absolute terms for smaller companies, compliance costs are higher in relative terms, averaging over 2.5% of revenue for companies with market capitalization under $100 million[7].

To attempt to reduce this burden, the SEC published guidance on Section 404 compliance in June 2007[8]. In 2009, the SEC's Office of Economic Analysis undertook a study to see whether the 2007 guidance was effective in reducing the costs of compliance. The report's positive results were delivered in the Fall

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4. Securities and Exchange Commission, *Final Rule: Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports*, available at http://www.sec.gov/rules/final/33-8238.htm (visited June 21, 2010).
5. 17 U.S.C. §7262.
6. See, e.g., Securities and Exchange Commission, *Spotlight On: Internal Control Reporting Provisions*, available at http://www.sec.gov/spotlight/soxcomp.htm (visited June 21, 2010).
7. See *FINAL REPORT OF THE ADVISORY COMMITTEE ON SMALLER PUBLIC COMPANIES TO THE U.S. SECURITIES AND EXCHANGE COMMISSION*, April 13, 2006 at p.33.
8. See *Commission Guidance Regarding Management's Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934*, June 27, 2007.

of 2009[9]; but the SEC determined that it was too late to impose the requirements of full 404 compliance by the end of 2009. Accordingly, the commission issued a further 6-month extension, but stated unequivocally that "there will be no further extensions of the compliance deadline."[10]

Therefore, beginning with the annual reports of companies with fiscal years ending on or after June 15, 2010,[11] all SEC-reporting issuers will be required to include both the company's assessment of its internal controls over financial reporting and the auditors' attestation to and report on the company's assessment.

9. Office of Economic Analysis, *Study of the Sarbanes-Oxley Act of 2002 Section 404 Internal Control over Financial Reporting Requirements,* September 2009.

10. Commissioner Luis A. Aguilar, *Statement of Commissioner Luis A. Aguilar Regarding His Commitment to Implementation of Sarbanes-Oxley Section 404(b)*, October 2, 2009.

11. Securities and Exchange Commission press release No. 2009-213 dated October 2, 2009.