THE VALUATION LAW REVIEW

Volume 19, Issue 3
August 2013

Corporate/Securities Decisions and Certain Canadian Regulatory Developments

The Valuation Law Review is a joint publication of The Canadian Institute of Chartered Business Valuators and Miller Thomson LLP and this issue summarizes corporate/securities decisions and certain canadian regulatory developments as of December 31, 2012 of interest to business valuators. 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.

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May 18, 2012
The Delaware Supreme Court affirmed an appeal from the decision of the Superior Court with respect to the legal effect to be given to "waiver" and "non-reliance" provisions contained in a confidentiality agreement. The Court rejected the potential purchaser's arguments that it should be able to recover due diligence costs and negotiating fees incurred in connection with the aborted transaction on the basis that the "waiver" and "non-reliance clauses" did not apply to "fraudulent inducement" by the potential vendor.

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Delaware Supreme Court
July 12, 2012
The Delaware Supreme Court affirmed an appeal from the Court of Chancery by upholding an injunction against Martin Marietta Materials, Inc. from pursuing a hostile take-over bid to acquire control of Vulcan Materials Company for a period of 4 months. The injunction had been initially issued by the Delaware Court of Chancery due to Martin Marietta Materials, Inc. breaching a non-disclosure agreement and a common interest, joint defense and confidentiality agreement relating to merger discussions with Vulcan Materials Company.

III. CERTAIN CANADIAN REGULATORY DEVELOPMENTS

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Filings of Exempt Distribution Reports

Securities legislation precludes issuers and underwriters from distributing securities without a prospectus. National Instrument 45-106 *Prospectus and Registration Exemptions* contains a number of exemptions from the prospectus requirement and requires issuers and underwriters relying on certain prospectus exemptions to report the exempt distributions in a particular form. Having observed recurring deficiencies with filed exemption forms, on April 26, 2012, the Canadian Securities Administrators issued CSA Staff Notice 45-308 – *Guidance for Preparing and Filing Reports of Exempt Distribution* under National Instrument 45-106 *Prospectus and Registration Exemptions*.

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Preparing and Filing Offering Memorandums under the Offering Memorandum Exemption

One of the popular prospectus exemptions that is available in all jurisdictions except Ontario is the Offering Memorandum Exemption set out in Section 2.9 of National Instrument 45-106 *Prospectus and Registration Exemptions*. Although an issuer's reliance on that exemption does not require prior approval as is the case for a distribution of securities pursuant to a prospectus, the use of the exemption is subject to regulatory oversight and monitoring. Having observed a number of common deficiencies in offering memoranda that were purportedly prepared in accordance with the required form, the Canadian Securities Administrators published CSA Staff Notice 45-309 — *Guidance for Preparing and Filing an Offering Memorandum* under National Instrument 45-106 *Prospectus and Registration Exemptions* to provide guidance to issuers and remind them of potential consequences of non-compliance.

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Emerging Market Review

Recognizing that the marketplace is becoming increasingly globalized and that emerging market issuers are important in both the global and Canadian marketplaces, the OSC commenced a regulatory review of emerging market issuers to assess: (i) the quality and adequacy of selected emerging issuers' disclosure and corporate governance practices; and (ii) the adequacy of roles carried out by auditors, underwriters and exchanges. On March 20, 2012, the Ontario Securities Commission released Staff Notice 51-719 regarding its Emerging Markets Issuer Review.

Summary of Caselaw, Legislative and Regulatory Developments 2012

The year 2012 included a number of decisions dealing with the equitable remedies and continuous disclosure standards. A few noteworthy cases also demonstrated that the courts and the law recognize the ever increasing globalized nature of our securities markets and modern technologies but that care must be taken to ensure a fair and appropriate process.

In *Southcott*, the Supreme Court of Canada's decision reminds us of the discretionary nature of equitable remedies as it wrestled with the decision as to whether a single purpose company seeking specific performance in the context of a real estate purchase has a duty to seek substitutable properties to mitigate its damages. As a general rule, a plaintiff will not be able to recover those losses which it could have avoided by taking reasonable steps (in this case seeking a substitute property). The Supreme Court of Canada pointed out the incompatibility of the concepts of specific performance and mitigation and ultimately found that there is a mitigation requirement even for single purpose companies and that to decide otherwise would expose defendants to higher damage awards when dealing with single purpose entities.

In *Fibrek*, the Québec Court of Appeal confirmed that a securities regulatory authority with specialized knowledge of capital markets and securities should be shown a high degree of deference and that a court should not interfere with such an authority's decision unless it is not justifiable, transparent or intelligible.

In *Canadian Solar Inc.*, the Ontario Court of appeal confirmed that an issuer that is not a reporting issuer, but that has a real and substantial connection to Ontario within the meaning of the Ontario *Securities Act* can constitute a "responsible issuer", and therefore be subject to a statutory cause of action by purchasers in the secondary market for a misrepresentation in the issuer's disclosure pursuant to s. 138.3 of the Ontario *Securities Act*, even if its securities are publicly traded only outside Canada.

In the *ESA* case, the Supreme Court of Canada applied the principle of technological neutrality which requires that the *Copyright Act* apply equally between traditional and more technologically advanced forms of the same media. The Court used this principle to recognize that with respect to downloaded copies of video games (as opposed to their counterparts sold on physical media), the Internet is simply a technological taxi that delivers a durable copy of the same work to the end user.

In *Garratt*, the Ontario Superior Court of Justice confirmed that when owners of private companies cannot make business decisions and are deadlocked such that business cannot be carried on properly, a court has the ability to make an order under the *Courts of Justice Act* or the *Business Corporations Act* to immediately appoint a receiver-manager to provide for an orderly wind up or sale of the business in order to preserve and protect the Companies' assets.

In *Russell*, the Alberta Securities Commission sanctioned Azteca Gold Corp.'s President and C.E.O. for breaching Alberta securities laws by causing Azteca Gold Corp. to make certain statements in news releases that he knew or reasonably ought to have known to be materially misleading, or misleading and untrue.

In *Klotia*, the Québec Superior Court confirmed that where the facts warrant oppression relief, a court may order relief in favour of a minority shareholder by removing the other directors and forcing a sale of shares from the oppressive shareholders to the minority shareholder.

In *Tracey*, the Superior Court of Justice upheld the trial judge's findings that if a court must decide which party should be required to sell his/her shares in a deadlock shareholder situation, the relevant issues the court must consider include the shareholder's ability to continue the business, the shareholder's ability to complete the purchase and the effect of the order on the other stakeholders of the company such as employees, customers and suppliers.

In *Mosquito*, the Supreme Court of British Columbia expressed its view that for Televote (which is something relatively new to the securities industry in Canada) to be effective, it is important that the industry take steps to establish appropriate protocols for its use to ensure that proxies and voting instructions are properly given and shareholders have the freedom to vote as they choose, particularly in contested meetings.

In *K-Sea*, the Delaware Court of Chancery held that in connection with unitholders' claims regarding breaches of fiduciary duties, a general partner is entitled to rely upon the provisions contained in a limited partnership agreement which bar such fiduciary duty claims and contractual claims, including where a provision in the limited partnership agreement that establishes a presumption of good faith bars claims for breach of the implied covenant of good faith and fair dealing.

2012 also saw two significant cases dealing with confidentiality agreements heard by the Delaware Supreme Court.

In *RAA Management*, the Delaware Supreme Court gave a broad scope to "waiver" and "non-reliance" clauses contained in a confidentiality agreement signed in connection with a potential acquisition transaction and rejected the potential purchaser's arguments that it should be able to recover due diligence costs and negotiating fees incurred in connection with the aborted transaction on the basis that the "waiver" and "non-reliance clauses" did not apply to "fraudulent inducement" by the potential vendor in connection with significant unrecorded claims and liabilities that caused the potential purchaser to abort its pursuit of the transaction.

In *Martin*, the Delaware Supreme Court confirmed that breaches of confidentiality agreements can cause "irreparable harm". The Supreme Court upheld the Chancery court's enjoining order of a hostile bid that took advantage of confidential information used by the bidder contrary to the provisions of the confidentiality agreements.

The Canadian Securities Administrators (CSA) issued guidance to issuers and underwriters in connection with preparing and filing reports of exempt distribution. Although responsibility for compliance with the National Instrument distributions that are exempt from the prospectus requirement rests with the issuer or underwriter relying on the applicable exemptions, the use of a prospectus exemption under National Instrument 45-106 *Prospectus and Registration Exemptions* remains subject to regulatory oversight and monitoring by the CSA and the securities administrators review filings pursuant to compliance monitoring programs, observed market activity and as follow up to specific complaints or referrals.

The CSA also issued guidance to issuers on preparing and filing an offering memorandum in reliance on the offering memorandum exemption which is available in all jurisdictions other than Ontario. The CSA observed 19 different issues which repeatedly raised concerns and they reminded issuers that failing to comply with the relevant requirements may result in a CSA regulator: (i) requiring the issuer to file a revised or amended document; (ii) requiring the issuer to prepare and deliver an updated offering memorandum to existing purchasers; (iii) requiring the issuer to grant rescission rights to certain investors; (iv) imposing a cease trade order and/or (v) taking enforcement action.

Lastly, in its Emerging Markets Issuer Review, the OSC published its report regarding a regulatory review of selected emerging market issuers designed to assess the quality and adequacy of disclosure and corporate governance practices and the adequacy of roles carried out by auditors, underwriters and exchanges.

Certain Caselaw Developments

I. CANADIAN CASES

Southcott Estates Inc. v. Toronto Catholic District School Board
2012 SCC 51
Supreme Court of Canada
March 20, 2012

The Supreme Court of Canada had to determine whether a single purpose company seeking specific performance in the context of a real estate purchase has an obligation to mitigate its losses (by making efforts to find a substitute property) when a vendor breaches the agreement of purchase and sale, and particularly when the plaintiff had promptly brought an action for specific performance.

The Facts and Lower Level Decisions
The Plaintiff Southcott Estates Inc. (Southcott) was a single purpose corporation that was incorporated specifically to purchase a parcel of land from the Toronto Catholic District School Board (School Board).

Pursuant to the purchase agreement, Southcott paid a 10% deposit and the closing was conditional on the School Board obtaining a severance of the land on or before the closing date. Southcott had no assets other than money advanced to it by its parent company for the deposit relating to the purchase.

In the intervening period between the agreement being signed and the closing, the School Board's request for severance was denied by the Committee of Adjustments and the School Board subsequently refused to extend the closing date.

Southcott responded to the School Board's actions by seeking specific performance of the contract and argued that it was not required to mitigate its losses on the grounds that it had been created solely for the purpose of purchasing the land in question.

At trial, the Superior Court of Justice judge concluded that there were no comparable properties available for purchase by Southcott but it refused to award Southcott with specific damages (i.e. completion of the sale agreement) on the basis that the property was not unique in nature and that monetary damages were adequate. Southcott was granted an award of $1,935,500.

On appeal, the Court of Appeal concluded that the School Board had indeed breached its contractual obligations but that Southcott had also failed to take available steps to mitigate its losses. The Court of Appeal's decision resulted in the initially awarded damages being reduced to a nominal sum.

The Supreme Court of Canada Decision
In rendering her decision, Madame Justice Karakatsanis found that the concepts of specific performance and mitigation were not compatible, and she addressed the question of when a plaintiff seeking specific performance can avoid the requirement for mitigation. In particular, Madame Justice Karakatsanis opined that:

> "A plaintiff deprived of an investment property does not have a "fair, real, and substantial justification" or a "substantial and legitimate" interest in specific performance unless he can show that money is not a complete remedy because the land has "a peculiar and special value" to him."

With respect to Southcott's status as a single purpose company created specifically for the purchase of the property in question, Justice Karakatsanis wrote:

> "In addition, not requiring single-purpose corporations to mitigate would expose defendants contracting with such corporations to higher damage awards than those reasonably claimed by other plaintiffs, based solely upon their limited assets."

In rejecting Southcott's arguments, Justice Karakatsanis found that there was a requirement for single-purpose corporations to mitigate their losses when seeking specific performance where there is no compelling reason why damages would not be appropriate.

As a lone dissenter, Chief Justice McLachlin opined on the inconsistency of requiring mitigation where a claim for specific performance is reasonably sought. She wrote that that the Board, having breached the agreement, bore the onus of proving that Southcott unreasonably failed to mitigate its loss and that such onus entailed establishing on a balance of probabilities that: (i) Southcott had an opportunity to mitigate its loss; and (ii) Southcott unreasonably failed to pursue that opportunity.

In her analysis, Chief Justice McLachlin found that neither the evidence of the Board's expert witness nor that of purchases by other subsidiaries of Soutcott's parent company established that a comparable property was available for purchase by Southcott. She went on to note that although the common law presumption of uniqueness of real property is no longer recognized, the land in question in this case was sufficiently unique that a substitute property of equivalent value was simply not readily available and she could not conclude that Southcott unreasonably failed to mitigate given that it lacked the financial capacity to go into the marketplace and purchase a substitute property.

AbitibiBowater inc. (Produits forestiers Resolu) c. Fibrek inc.
2012 QCCA 569
Québec Court of Appeal
March 27, 2012

The Québec Court of Appeal, in reversing a decision of the Court of Québec and reinstating a cease trade order originally implemented by Québec's securities regulatory authority, the Bureau de décision et de révision (Bureau) confirmed that deference should be afforded to the Bureau's specialized knowledge of capital markets and securities and that an auction process unhindered by defensive tactics is in the best interest of shareholders.

The Facts and Lower Level Decisions
On November 28, 2011, Abitibi Inc., doing business as Resolute Forest Products and RFP Acquisition Inc. (Abitibi) publicly announced its intention to commence a formal bid for all of the outstanding common shares of Fibrek. The bid offered consideration of $1.00 per share which represented a 31% premium over the then market price of Fibrek's shares. The consideration was offered to Fibrek's shareholders in the forms of cash, cash and shares or shares only.

In anticipation of its bid, Abitibi had previously entered into irrevocable lock-up agreements to secure the support of Fibrek's three largest shareholders who collectively held approximately 46.5% of Fibrek's shares.

In response to the unsolicited bid, on December 19, 2011 Fibrek's board of directors unanimously recommended to Fibrek's shareholders that they reject Abitibi's bid on the basis that the hostile bid undervalued the price of the shares. Fibrek's board also adopted a shareholder rights plan (also known as a poison pill) to counter Abitibi's offer. On February 3, 2012, Fibrek's board of directors received a formal valuation of the shares valuing them at between $1.25 and $1.45 per share. Fibrek's shareholder rights plan was later cease traded by the Bureau on February 9, 2012.

Fibrek's board sought alternatives to the Abitibi offer and on February 10, 2012 it succeeded in finding a "white-knight" in the form of Mercer International Inc. (Mercer) which made an offer of $1.30 per Fibrek share (again payable in the forms of cash, cash and shares or shares only). In connection with the white-knight strategy, Fibrek simultaneously agreed to a private placement to Mercer of special warrants which represented 19.9% of Fibrek's shares if exercised. Fibrek and Mercer also entered into a support agreement which provided Mercer with a break fee of $8.5 million which represented 5% of Fibrek's shareholder equity.

Abitibi opposed the private placement and break fee on the basis that such actions were contrary to the public interest and requested that the Bureau cease trade both the private placement and Mercer's bid.

The Bureau's Decision
On February 23, 2012, the Bureau exercised its public interest discretionary power to order a cease trade of the private placement issuance of securities by Fibrek to Mercer.

The Bureau found that as opposed to other cases where there was a demonstrated pressing need for capital, the purpose of the Mercer private placement was specifically as a defensive tactic to thwart off Abitibi's bid and influence Fibrek's shareholders' ability to make a decision between the competing offers.

In particular the Bureau held that while defensive measures against takeovers are not illegal on their own, when such measures affect the ability of shareholders to freely vote their preference in favour of a fair offering, the Bureau should exercise its public interest discretion as to not permit such defensive measures. In this case, to permit the private placement would allow Fibrek's board to interfere with Abitibi's validly negotiated lock up agreements which is prejudicial to the auction process and affects the fundamental right of shareholders to decide for themselves whether they wish to tender their shares to an offer.

The Bureau also commented that the 5% break fee was unwarranted and that together with the private placement, it constituted an abusive defensive measure.

The Court of Québec Decision
Upon hearing Fibrek's appeal, the Court of Québec released its decision on March 16, 2012.

The Court of Québec opined that the standard of review of the Bureau's decision is reasonableness and then commented on the public interest power of Canadian securities regulatory authorities.

Upon reviewing precedent set by the Ontario Securities Commission, the Court ruled that intervention in the public interest should be restricted to situations where it is necessary to counter unfair, improper or fraudulent practices as opposed to preventing a target company from finding superior offers by issuing warrants.

The Court went on to opine that where securities laws have not been violated, intervention is only acceptable where there is an abuse of shareholders specifically, or of capital markets generally.

In applying these principles to the Fibrek situation, the Court held that the Bureau erred in concluding that since the private placement was not contemplated in connection with a pressing need for financing, it was contrary to the public interest and the interests of the shareholders.

The Court further ruled that the Bureau's cease trade order would have the effect of prejudicing all shareholders, including the locked-up shareholders by eliminating the auction process that could yield a superior share price. Moreover, the Court took the view that the cease trade order would prevent shareholders from exercising their judgement as to which of the competing offers was superior, which the Court believed undermined the views of Canadian securities regulatory authorities outlined in National Policy 62-202 (the national policy with respect to the use of defensive tactics in the context of takeover bids).

Based on the above conclusions, the Court held that the Bureau's decision was unreasonable and granted Fibrek's appeal. The Court further ruled that the maximization of shareholder value, even for shareholders who had agreed to sell their shares at a lower price, is a principle that should take precedence over the benefits of preserving the effects of validly negotiated lock-up agreements.

The Court of Appeal Decision

The Québec Court of Appeal released its judgement on March 27, 2012 in which it reversed the decision of the Court of Québec and reinstated the cease trade order originally implemented by the Bureau.

In reaching its decision, the Court of Appeal reviewed the Bureau's decision and the Court of Québec's findings, particularly in respect of the Bureau's determination that Fibrek did not have a pressing need for capital to justify the private placement and the Court of Québec's view that the private placement would maximize shareholder value.

The Court of Appeal first considered the degree of deference that should be given to the Bureau. The Court of Appeal concluded that Bureau, in light of its specialized knowledge of capital markets and securities, was granted a broad and unfettered power to act in the public interest by the legislature. Accordingly, the Court reasoned that when an independent and specialized organization such as the Bureau reaches a decision, that decision must be shown a high degree of deference and therefore the decision is not to be interfered with unless it is not justifiable, transparent or intelligible.

Applying this deference, the Court of Appeal placed great weight on the Bureau's finding that Fibrek's private placement was a defensive tactic which was not motivated by a legitimate business concern and that unjustifiably interfered with validly negotiated lock-up agreements and the ability of shareholders to choose between the offers themselves.

The Court of Appeal further held that based on the facts of the case, the jurisprudence and the evidence, it was not possible of the Court of Québec to conclude that the decision of the Bureau was unjustifiable. Moreover, the Court of Appeal opined that it was incorrect for the Court of Appeal to substitute itself "for the Bureau to make decisions of a regulatory nature in the public interest by choosing the minority shareholders' interests over the majority shareholders' choices which are not oppressive or abusive, instead of favouring the stability of a public bidding process unfettered by defensive tactics," a principle recognized by all the Canadian securities regulatory authorities.

The Supreme Court of Canada Denies Leave to Appeal

On April 18, 2012, the Supreme Court of Canada refused applications for leave to appeal from the judgment of the Québec Court of Appeal.

Abdula v. Canadian Solar Inc.
2012 ONCA 211
Ontario Court of Appeal
March 30, 2012

Canadian Solar Inc. (Canadian Solar) appealed a motion judge's decision that it was a "responsible issuer," as defined in s. 138.1 of the Ontario *Securities Act* (Securities Act). The Ontario Court of Appeal confirmed the motion judge's decision and ruled that an issuer that is not a reporting issuer, but that has a "real and substantial connection" to Ontario within the meaning of the Ontario *Securities Act* can constitute a "responsible issuer," and therefore be subject to a statutory cause of action by purchasers in the secondary market for a misrepresentation in the issuer's disclosure pursuant to s. 138.3 of the Ontario *Securities Act*, even if its securities are publicly traded only outside Canada.

The Facts and the Decision of the Motions Judge

Canadian Solar, a NASDAQ listed Canadian corporation designed, developed, manufactured and sold solar cell and solar module products that convert sunlight into electricity for a range of uses. Canadian Solar's shares did not trade on the Toronto Stock Exchange or any other Canadian stock exchange.

Tajdin Abdula (Abdula) placed orders for Canadian Solar shares through his online discount brokerage, Bank of Montreal InvestorOnline, using his home computer in Markham, Ontario. As of August 26, 2010, Canadian Solar had 1,253 shareholders in Ontario who, in the aggregate held over one million shares.

Abdula, as the proposed representative plaintiff in a putative class proceeding against Canadian Solar under class proceedings legislation alleged that Canadian Solar made misrepresentations contained in press releases, financial statements and an annual report and materially overstated its financial results.

The statutory cause of action created by s. 138.3 of the *Securities Act* applies to a misrepresentation by a "responsible issuer" and the motions judge determined that Canadian Solar was a "responsible issuer" by virtue of it having a "real and substantial connection to Ontario."

The Court of Appeal Decision

Canadian Solar appealed the motion Judge's finding that Canadian Solar's shares did not have to be publicly traded in Canada for it to be within in the definition of "responsible issuer." More specifically, the issue on appeal was whether there is an implied

limit on the definition of "responsible issuer" that an issuer's securities must be traded in Canada.

The Court of Appeal noted that Section 138.1 of the *Securities Act* defines "responsible issuer" as:

(a) a reporting issuer, or

(b) any other issuer with a real and substantial connection to Ontario, any securities of which are publicly traded.

The Court of Appeal observed that Canadian Solar was not a reporting issuer in Ontario within part (a) of the definition and that it was therefore not required to file the documents containing the alleged misrepresentations with the Ontario Securities Commission (OSC). The Court of Appeal also observed that Canadian Solar was required to file such documents and did file them with the U.S. Securities Exchange Commission (SEC) pursuant to U.S. securities legislation.

The Court of Appeal found that while Canadian Solar's principal place of business was in the People's Republic of China, directly and through its subsidiaries, it had undertaken or engaged in numerous solar projects in Ontario. In addition, Canadian Solar had raised capital from Ontario investors through private placements and had made filings with the OSC confirming those activities.

Canadian Solar submitted that paragraph (b) of the definition of "responsible issuer" is confined to issuers with a real and substantial connection to Ontario, any securities of which are "publicly traded in Ontario or in another province or territory of Canada with comparable legislation imposing continuous disclosure obligations on reporting issuers and providing statutory liability for misrepresentation in secondary market disclosure."

Additionally, Canadian Solar argued that as comparable legislation has been enacted in all provinces and territories of Canada, the appropriate limitation could currently be worded "publicly traded in Canada." Canadian Solar took the position that since its shares were not publicly traded in Canada, it was therefore not a "responsible issuer" and accordingly, Mr. Abdula could not advance a statutory claim against it pursuant to section 138.3 of the *Securities Act*.

Counsel for Mr. Abdula argued that the best indicator of legislative intent is the words chosen by the legislature, and the legislature could have, but did not, add the words "in Canada" to paragraph (b) of the definition of "responsible issuer."

The Court of Appeal concluded that when the words "publicly traded" in paragraph (b) of the definition of "responsible issuer" are read in their entire context and in their grammatical and ordinary sense, harmoniously with the scheme of the *Securities Act*, the object of the *Securities Act* and the intention of the legislature, gleaned from the legislative history and the words chosen by the legislature, they do not mean "publicly traded in Canada."

The Court of Appeal also held that Abdula, being an Ontario resident who placed his order in Ontario for shares of a corporation based in Ontario, would reasonably expect that his claim for misrepresentations in documents released or presented in Ontario would be determined by an Ontario court.

The Supreme Court of Canada Denies Leave to Appeal
On November 29, 2012, the Supreme Court of Canada refused an application for leave to appeal from the judgment of the Ontario Court of Appeal.

Entertainment Software Association and Entertainment Software Association of Canada and Society of Composers, Authors and Music Publishers of Canada
2012 ONCA 211
Supreme Court of Canada
July 12, 2012

Based on the principle of technological neutrality, the Supreme Court of Canada allowed an appeal against the Federal Court of Appeal's upholding of the Copyright Board's conclusion that the download of a file containing a musical work is a communication to the public by telecommunication within the meaning of s. 3(1)(f) of the *Copyright Act*, entitling SOCAN's members to compensation in accordance with an approved tariff.

The Facts and Lower Level Decisions
The Entertainment Software Association and the Entertainment Software Association of Canada (collectively, ESA) represented a broad coalition of video game publishers and distributors who enable customers to download copies of video games from the internet that are identical to copies purchased in stores or shipped to customers by mail.

The video games contained copyrighted musical works and the royalties for the reproduction of those musical works were negotiated before the games were sold to the public.

The Society of Composers, Authors and Music Publishers of Canada (SOCAN), the entity which administers the right to "communicate" musical works on behalf of copyright owners, applied to the Copyright Board for a tariff covering downloads of musical works over the internet.

The Copyright Board concluded that the download of a file containing a musical work is a communication to the public by telecommunication within the meaning of s. 3(1)(f) of the *Copyright Act*, entitling SOCAN's members to compensation in accordance with an approved tariff.

On judicial review, the Federal Court of Appeal upheld the Copyright Board's decision.

The Supreme Court of Canada Decision
The Supreme Court of Canada focussed on the meaning of the word "communicate" in s. 3(1)(f) of the *Copyright Act*, a term that is not defined in the *Act*.

The Court reviewed the facts that SOCAN applied to the Copyright Board for a tariff under this provision to cover downloads of musical works over the internet and that the ESA objected to the tariff, arguing that "downloading" a video game containing musical works did not amount to "communicating" that game to the public by telecommunication under s. 3(1)(f).

The Supreme Court of Canada made further note of the ESA's assertions that:

1) a "download" is merely an additional, more efficient way to deliver copies of the games to customers;
2) the downloaded copies are identical to copies purchased in stores or shipped to customers by mail; and

3) the game publishers already pay copyright owners reproduction royalties for all of these copying activities.

In agreeing with the ESA, the Supreme Court of Canada stated that in its view, the Copyright Board's conclusion that a separate, "communication" tariff applied to downloads of musical works violates the principle of technological neutrality, which requires that the *Copyright Act* apply equally between traditional and more technologically advanced forms of the same media.

The Court further opined that the principle of technological neutrality is reflected in s. 3(1) of the *Copyright Act*, which describes a right to produce or reproduce a work "in any material form whatever." Accordingly, the Court stated that it did not recognize any practical difference between buying a durable copy of the work in a store, receiving a copy in the mail or downloading an identical copy using the internet.

The Court summarized that with respect to downloaded copies of video games (as opposed to their counterparts sold on physical media), the internet is simply a technological taxi that delivers a durable copy of the same work to the end user.

Garratt v. Charlton et al.
ONSC
Ontario Superior Court of Justice
February 16, 2012

Pursuant to a motion seeking the appointment of a receiver-manager to preserve Charlton's interest in companies indirectly owned by Charlton and Garratt, the Court granted an order appointing Grant Thornton as interim receiver-manager since the parties would not have been able to resolve their disagreement or provide for an orderly winding up or sale of their corporations.

The Facts

Warren Garratt (Garratt) and Robert Charlton (Charlton) each owned 50% of the shares of three operating companies (Companies) through their respective wholly-owned holding companies. Garratt and Charlton were the sole officers, directors and indirect shareholders of the Companies which had operated successfully for 24 years designing and manufacturing industrial parts and fittings.

In June 2011, Garratt and Charlton had a "falling out" and as a result of the disagreement, Garratt and Charlton had been unable to agree on or make business decisions since June 2011. The result of this impasse negatively affected the Companies which ceased to carry on business.

Royal Bank of Canada, the Companies' banker, became aware of the disagreement between the Garratt and Charlton and in August 2011, the bank froze all business accounts of the Companies and made them "deposit only." The Royal Bank of Canada also advised Garratt and Charlton that it would continue to keep the Companies' accounts on "hold" until there was an agreement between Garratt and Charlton.

The Companies operated from rental premises in Mississauga. The Companies have significant machinery and equipment located in the rental premises which expired in June 2011. The lease had not been renewed and the tenancy continued on a month-to-month basis. The Companies also had some cash in the corporate bank account and owned equipment and machinery with significant value.

The parties could not agree on the necessary decisions to carry on business, to wind it up or the sell it and both parties alleged the other had acted unreasonably and improperly resulting in cross allegations of oppression and deadlock.

By September 14, 2011, Garratt commenced an application seeking amongst other relief, an order for the winding up of the Companies and one of the remedies sought was the appointment of a receiver-manager to provide for an orderly disposition or winding up of the Companies.

The Decision

In hearing the application and the facts, Justice Ricchetti reviewed the Court's ability to appoint a receiver-manager under s.101 of the *Courts of Justice Act* and s.248 of the Ontario *Business Corporations Act*.

The Court noted that s. 101 of the *Courts of Justice Act* provides that the court may appoint a receiver by interlocutory order "where it appears to a judge of the court to be just or convenient to do so." The Court then reviewed the governing principles including the following:

(a) the appointment of a receiver to preserve assets for the purposes of execution is extraordinary relief, which prejudges the conduct of a litigant, and should be granted sparingly;

(b) the appointment of a receiver for this purpose is effectively execution before judgment and to justify the appointment there must be strong evidence that the plaintiff's right to recovery is in serious jeopardy;

(c) the appointment of a receiver is very intrusive and should only be used sparingly, with due consideration for the effect on the parties as well as consideration of the conduct of the parties; and

(d) in deciding whether to appoint a receiver, the court must have regard to all the circumstances, but in particular the nature of the property and the rights and interests of all parties in relation thereto;

The Court also reviewed s. 248(1)–(3) of the Ontario *Business Corporations Act* and noted that where the court is satisfied that in respect of a corporation any act or omission of the corporation or any of its affiliates effects or threatens to effect a result that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer of the corporation, the court may make an order to rectify the matters complained of and that such an order can include appointing a receiver-manager.

Applying the foregoing principles in its analysis, the Court then held that a receiver-manager was necessary under both s. 101 of the *Courts of Justice Act* and s. 248 of the Ontario *Business Corporations Act*. Justice Ricchetti opined that the situation was such that the appointment of a receiver-manager was not a drastic step; it was necessary and the only step that might preserve some value in the Companies. Additionally Justice Ricchetti commented that the expense of a receiver-manager must be considered in light of the likely consequences should a receiver-manager not be appointed.

The only issue that then remained was whether the appointment of a receiver-manager should be delayed to permit the parties to negotiate a resolution that would avoid the costs of a receivership as Garratt requested time to negotiate a resolution whereas Charlton did not believe anything would be accomplished.

The Court refused to provide any additional time to negotiate and commented that while it would be more financially viable to the parties to resolve the issues, "there appears to be no hope the parties would be able to do so. They have not resolved the issues since June 2011 and it is now February 2012 without resolution even on minor issues….I am satisfied that the Companies are at serious risk and immediate steps must be taken to preserve and protect the Companies. In a few months there will be nothing to liquidate or wind up."

Re: Russell
2012 ABASC 43
Alberta Securities Commission
February 2, 2012

The Alberta Securities Commission found that Azteca Gold Corp.'s President and C.E.O., Matthew Russell breached Alberta securities laws by causing Azteca Gold Corp. to make certain statements in eight corporate news releases "when he knew or reasonably ought to have known them to be materially misleading, or misleading and untrue."

Russell was barred from serving as a director or officer of any issuer for five years and was also ordered to pay an administrative penalty of $150,000 and investigation and hearing costs of $40,000.

The Facts
Matthew Russell (Russell) was the President, C.E.O. and Chairman of Azteca Gold Corp. (Azteca), an Alberta corporation engaged in mineral exploration whose shares were listed on the TSX Venture Exchange (TSXV).

Edward Schiller (Schiller) was also an Azteca director and was initially Azteca's "qualified person" as defined in National Instrument 43-101 *Standards of Disclosure for Mineral Projects* (National Instrument).

Azteca held a 50% joint venture interest in a mineral property known as "Two Mile" in Idaho. During the period from January 2009 to June 2009, Azteca issued eight news releases containing a number of statements (Releases) that represented that Two Mile had "massive mineralization" and that one hole was "on target for developing mineral resource." The Releases also indicated that Two Mile had properties similar to a proven successful mine known as the Sullivan mine.

In the first news release Schiller was named as Azteca's qualified person but all subsequent statements listed Russell as the qualified person. Schiller had resigned from Azteca in March 2009 after citing a number of reasons, including the fact that he did not agree with the direction being taken by the company.

Subsequent to a review by Canadian securities regulators of Azteca's disclosure, Azteca issued a news release in July 2009 clarifying that more data and analysis was needed and that the comparisons to the Sullivan mine were being re-evaluated; however, this additional disclosure was still insufficient compared to what was requested as the regulators questioned Russell's qualifications as the qualified person and the press release failed to address that concern.

The TSXV ordered a halt trading of Azteca's shares in August 2009 which was later lifted after Azteca issued another press release in September 2009 indicating that Russell was no longer Azteca's qualified person.

The Hearing

On February 2, 2012, Staff of the Alberta Securities Commission (Commission) alleged that Russell had made or caused to be made, the Releases which were misleading or untrue, contrary to s.92(4.1) of the Alberta *Securities Act* and that Russell had breached the National Instrument by acting as Azteca's qualified person.

In its decision, the Commission outlined the National Instrument's disclosure standards for mineral projects which require that scientific information be prepared or supervised by a qualified person and that correct terminology be used. In particular, the Commission noted that to be a "qualified person," the individual must:

(i) be an engineer or geoscientist with at least five years of experience in mineral exploration, mine development or operation or mineral project assessment, or any combination of these;

(ii) have experience relevant to the subject matter of the mineral project; and

(iii) be in good standing with a relevant professional association.

The Commission noted that Russell was an engineer with some operational and project management experience in the mining sector; however, it determined that Russell lacked the experience relevant to the Two Mile project as it stood in the first half of 2009 which was at a very early stage of information gathering and interpretation. The Commission therefore found that Russell was not eligible to act as Azteca's qualified person in respect of the Two Mile project in the first half of 2009, and that his acting as such breached section 2.1 of the National Instrument and was also contrary to the public interest.

The Commission further commented that notwithstanding the existence of some cautionary language that was "sprinkled throughout the Releases, we found that statements in them were materially misleading and (in at least some instances) untrue. Specifically, we found that statements deliberately conveying the impression that Two Mile was or would become a mineral resource capable of being produced, technically and economically, even though neither Azteca nor Russell was in any position to reach such a conclusion at the time, were materially misleading."

The Commission also found that "the highly optimistic picture presented by other statements in the Releases, in the absence of requisite technical or scientific foundation or the sort of care and balance that the topic demanded, were materially misleading and (in at least some instances) untrue. We further found that Russell, having effectively been warned by a fellow Azteca director, knew or reasonably ought to have known that these statements – which he had made and caused Azteca to make – were materially misleading and (in at least some instances) untrue, and that he therefore breached section 92(4.1) of the Act and also acted contrary to the public interest."

The decision noted that concurrent with some of the Releases, Azteca raised money from investors in a private placement (Private Placement), which closed on June 29th and that on or about June 22, 2009, Azteca and its disclosure came under review by Canadian securities regulatory staff, who communicated their concerns to Azteca.

A Commission staff letter dated June 26, 2009 (Staff Letter) required Azteca to issue "a comprehensive and detailed clarifying news release retracting and restating its previous disclosure, as necessary," citing concerns about references to "development of a mineral resource," purported similarities to the Sullivan mine and implications of economic viability of deep-mining at Two Mile.

Azteca responded to the Staff Letter with a news release after the close of trading on July 3, 2009 (First Clarifying Release) which was a few days after the Private Placement closed. The Commission noted that the First Clarifying Release "combined optimism with some blunt warnings about Azteca's prior disclosure" but continued to identify Russell as Azteca's qualified person.

Due to continuing concerns about its level of disclosure, on September 14, 2012 Azteca issued another release (Second Clarifying Release) which announced Russell's replacement as Azteca's qualified person, cautioned investors that prior disclosure suggesting mineability or economic viability or implying metal grades at Two Mile was premature and should not be relied on, and warned specifically about certain prior disclosure that could not be relied on or was mistaken.

The Commission determined that the First Clarifying Release jolted the market analyzing that on the first trading day after its issuance (July 6, 2009), Azteca shares traded in high volume at sharply lower prices. After having closed on July 3, 2009 at $0.49 per share, they opened on July 6, 2009 at $0.29 per share and ended the day at $0.23 per share, a 53% plunge from the July 3, 2009 closing price. The price drifted generally lower (as low as $0.14) into the first week of August.

The Commission ruled that Russell's conduct "impaired the ability of investors to make properly informed investment decisions." The Commission determined that "The potential harm is broad and foreseeable. Investors who bought Azteca securities in the first half of 2009, in the face of the improper disclosure, appear to have been directly and quantifiably harmed."

Following the hearing, on June 13, 2012, the Commission barred Russell from serving as a director or officer of any issuer for five years and was also ordered to pay an administrative penalty of $150,000 and investigation and hearing costs of $40,000.

Klotia v. Singh
Québec Superior Court
January 6, 2012

The Québec Superior Court had to determine whether oppression relief sought by a minority shareholder warranted removing the other directors and requiring a sale of the oppressive shareholder's shares to the minority shareholder at a price equal to the original price paid for his shares by the minority shareholder.

The Facts

In October 2009, Gurwinder Singh Klotia (Klotia), Harpreet Singh (Singh) and Maribel Estrada (Estrada) incorporated Arc-En-Ciel Inc. (Corporation) for the purpose of carrying on a farming business.

Klotia held 49% of the Corporation's shares and was a director and the vice-president. Singh owned 51% of the Corporation's shares and was a director and the president. Estrada was a director.

In May 2010, the Corporation purchased a farm property and financing for the acquisition was provided through a hypothec issued by a financial institution which was in turn guaranteed by each of Klotia and Singh. In addition to their guarantees, Klotia and Singh provided investments in the amount of $122,990 and $128,010, respectively.

Klotia also provided additional funds in response to Singh's requests but did not receive information regarding how those funds were to be used. Following Singh's and Estrada's lack of involvement with the operation of the Corporation, Klotia brought an action for oppression in which he sought removal of both Singh and Estrada from their positions as directors of the Corporation and an order requiring Singh to sell his shares in the Corporation to Klotia.

The Claim

Klotia submitted that Singh and Estrada had conducted the business and affairs of the Corporation in a manner that was oppressive and unfairly prejudicial to him, as a shareholder, director and officer of the Corporation. Accordingly, Klotia argued that he was entitled to one or more of the remedies provided under sections 451 and 452 of the Québec *Business Corporations Act*, including an order requiring Singh to sell to Klotia his shares in the Corporation.

The Decision

The Québec Superior Court had to determine whether:

(i) Singh and Estrada had been conducting the Corporation's affairs in a manner that was oppressive or unfairly prejudicial to the interests of Klotia as a minority shareholder and if so, to determine whether their removal as directors and the sale of Singh's shares to Klotia were appropriate remedies; and

(ii) if a sale share was to be determined as an appropriate remedy, would the amount of Singh's initial investment in the Corporation represent an appropriate purchase price.

The Court embarked upon a review of the law and noting section 450 the Québec *Business Corporations Act* which provide as follows:

> 450. An applicant may obtain an order from the court to rectify a situation if the court is satisfied that
>
> (1) any act or omission of the corporation or any of its affiliates effects or threatens to effect a result,
>
> (2) the business or affairs of the corporation or any of its affiliates have been, are or are threatened to be conducted in a manner, or
>
> (3) the powers the board of directors of the corporation or any of its affiliates have been, are or are threatened to be exercised in a manner that is or could be oppressive or unfairly prejudicial to any security holder, director or officer of the corporation.

The Court then observed that section 439 of the Québec *Business Corporations Act* defines an applicant as follows:

> 439. Applications under subdivisions 2 and 3 may be made by any of the following:
>
> (1) a registered holder or beneficiary, and a former holder or beneficiary, of a security of a corporation or any of its affiliates;
>
> (2) a director or an officer or a former director or officer of a corporation or any of its affiliates;
>
> (3) any other person who, in the discretion of the court, has the interest required to make an application under this division.

Applying the law to the facts at hand, the Court found that as a registered holder of the Corporation's shares and as a director and officer of the Corporation, Klotia was qualified to be an applicant under section 450 of the Québec Business Corporations Act.

The Court also cited that it "has no doubt that Singh and Estrada have been conducting the business or affairs of Arc-en-Ciel in a manner that is oppressive or unfairly prejudicial to Klotia."

The Court retains from the proof, *inter alia*, the following:

> "a. notwithstanding numerous requests, Klotia has been kept in the dark by Singh and Estrada as to Arc-en-Ciel's operations and business;
>
> b. Klotia was required by Singh and Estrada to provide additional funding, despite the fact that they refused to give any financial information to him with respect to Arc-en-Ciel's affairs;
>
> c. cheques have been issued by Singh and Estrada on the account of Arc-en-Ciel with no supporting documents and for non-business purposes, including to repay alleged loans from relative or friends, and to pay for their personal expenses, including the rent of the Registered Office used as their residence."

Based on the foregoing, the Court held that both Singh and Estrada had engaged in conduct which was oppressive and unfairly prejudicial to Klotia.

In considering the appropriate remedy to be provided, the Court determined that since: (i) Singh and Estrada had control over the Corporation's board of directors; (ii) neither Singh nor Estrada demonstrated any interest in maintaining their status as directors; (iii) Singh and Estrada had failed to communicate with either Klotia or the Corporation; and (iv) Singh and Estrada failed to attend to the Corporation's business by allowing invoices from suppliers to remain unpaid which caused serious prejudice to the Corporation's business and its creditors, it was appropriate to remove Singh and Estrada as officers and directors of the Corporation.

The Court also concluded that Klotia's proposed purchase price of $128,010, representing the amount of his original investment was, in the circumstances, a generous offer and the Court therefore issued an order for a sale of the shares at that price.

Tracey v. Tracey Inc.
2012 ONSC 3144
Ontario Superior Court of Justice
June 14, 2012

The Ontario Superior Court of Justice upheld the trial judge's findings that if a court must decide which party should be required to sell his or her shares in a deadlock shareholder situation, the relevant issues the court must consider include the shareholder's ability to continue the business, the shareholder's ability to complete the purchase and the effect of the order on the other stakeholders of the company such as employees, customers and suppliers.

The Facts
Elizabeth Tracey (Elizabeth) and her eldest son, Mark Tracey (Mark) owned and operated an ice cream business known as Centreside Dairy. Elizabeth held 51 shares and Mark held 49 shares.

After 10 years of dispute, the parties were in a deadlock for the management and control of the business.

Elizabeth and Mark were unanimous that the corporation should not be wound up and that one side or the other ought to end up owning the entire business.

The Trial Decision

At a trial held before Justice Roy, the Court observed that sections 207 and 248 of the Ontario *Business Corporations Act* "give the court a very broad discretion to fashion a remedy to rectify a problem such as this one."

The Court went on to opine that "Clearly in this case the actions of the parties at various times have been burdensome, harsh or wrongful. The parties' conclusion that there is a state of deadlock is certainly justified. The fact that this is a family owned corporation and there no longer exists any trust and confidence amongst the members of the family means the corporation cannot continue to function and meet the reasonable expectation[s] of the shareholders. The just and equitable remedy will be to either wind up the company pursuant to section 207 of the *Act* or to have one shareholder buying the other's shares at a reasonable price."

Noting that "the parties are unanimous that the corporation should not be wound up and accordingly that leads to the only other remedy, that of a forced sale," the Court focused its inquiry on determining which side should be required to sell his or her shares to the other side and what the sale price should be.

For the reasons affirmed by the Supreme Court of Justice as summarized below, the trial Court held that Elizabeth should be required to sell her shares to Mark for the calculated fair market value of $271,830.

The Appeal Decision

At the appeal heard by the Ontario Superior Court of Justice, the Court paid great deference to the trial decision and noted that the following factors considered by Justice Roy in deciding which party ought to be required to sell to the other were appropriate:

1) Who has the best ability to continue the business?
2) Which shareholder has contributed the most to the deadlock?
3) Who has the ability to purchase the other's shares?
4) What weight should be accorded Elizabeth's majority holding (51 shares) and Mark's minority position (49 shares) in the company?
5) What effect will the order have on the continued viability of the company?
6) What effect will the order have on other stakeholders in the company, such as its long-term employees, customers and suppliers?

The appellants argued that in ordering Elizabeth to sell her shares to Mark, Justice Roy erred by disregarding Elizabeth's "reasonable expectations as a shareholder" and that among other things, he failed to consider: (i) oppressive conduct by Mark towards Elizabeth in various ways, including failing to call regular shareholders and directors meetings, thus excluding Elizabeth from meaningful participation in a company in which she held a majority of the shares; and (ii) Mark's oppressive conduct in creating and operating "Tracey's Dairy" to distribute ice cream products which the appellants submitted was a corporate opportunity from which Elizabeth was wrongfully excluded.

The Court did not accept those arguments and placed great weight on Justice Roy's findings that:

1) Mark had the best ability to continue to operate Centreside Dairy effectively;
2) Mark had the wherewithal to purchase Elizabeth's shares, but there was good reason to doubt that Elizabeth could pay for Mark's shares;
3) the continued viability of the business would be jeopardized by removing Mark and placing control in Elizabeth's hands;
4) the financial risk to the company would imperil the chances of Elizabeth being able to pay for Mark's shares;
5) long term employees and other stakeholders in the company would be placed at risk if Mark was removed and Elizabeth was placed in control of the business; and
6) even though Elizabeth held a majority of shares, this factor is overwhelmed by the other factors in favour of requiring her to sell her shares to Mark.

With respect to the alleged diversion of corporate opportunity and self-dealing argument, the appellants argued that Mark appropriated a business opportunity that properly belonged to Centreside when he established and operated a distribution company that carried on business as "Tracey's Dairy."

The Court agreed with Justice Roy's findings that Mark had not diverted a corporate opportunity or breached any fiduciary duties as a director of Centreside.

In coming to that conclusion, the Court observed the following legal points:

- A director of a company has a fiduciary relationship to his corporation that requires him to be loyal to the corporation, to act in good faith, and to avoid conflict of duty. The nature and extent of fiduciary duties are examined in the overall context in which they arise.
- A director may not obtain for himself without the knowledge or consent of the company any property or business advantage which belongs to the company.
- A director is precluded from obtaining for himself, directly or beneficially, a maturing business opportunity for which the company has been negotiating, especially where the director has been negotiating for the business advantage on behalf of the company.
- A "mere idea" is not a business opportunity in this context. It is a "maturing" or "ripe" business opportunity, immediately available to the corporation, that constitutes a business advantage or opportunity that the fiduciary may not be appropriate to him. On the other hand, a director may pursue a business opportunity that the corporation has rejected, or that the corporation is unable or unwilling to pursue.

Applying the foregoing maxims to the case at hand, the Court found that Centreside did not lose out on a business opportunity because: (i) the business opportunity was not practically available to Centreside in the first place as its banking restrictions would not have permitted it to raise the necessary capital to embark on the business; and (ii) the appellants had no intention of operating a distribution company.

International Energy and Mineral Resources Investment (Hong Kong) Company Limited v. Mosquito Consolidated Gold Mines Limited
2012 BCSC 1191
British Columbia Supreme Court
August 8, 2012

The British Columbia Supreme Court heard a challenge to the use of a televote system in the conduct of contested shareholder meetings of publicly traded companies in British Columbia. In its ruling in favour of the petitioner, the Court observed that any effective voting system must encompass sufficient safeguards to ensure that proxies and voting instructions are properly given and shareholders have the freedom to vote as they choose.

The Facts

International Energy and Mineral Resources Investment (Hong Kong) Company Limited (International Energy), held the largest number of shares in the respondent company, Mosquito Consolidated Gold Mines Limited (Mosquito). Mosquito's shares traded on the TSX Venture Exchange.

The president and CEO of the International Energy is Hongzue Fu, who is also a former director and chairman of the board of Mosquito.

Mosquito's Annual and Special General Meeting held on December 16, 2011 (Meeting), was a contested one as two different slates of directors were proposed for election.

Both management and dissident circulars and proxies were sent to shareholders in advance of the Meeting and each side retained professionals to assist them with soliciting proxies and voting instructions.

The dissident side was organized by Mr. Fu and Shaun Dykes. Mr. Dykes was a shareholder and also a former director and former Exploration manager of Mosquito. They proposed a slate of five directors, including themselves.

Meanwhile, the management side proposed a slate of eight directors, excluding Mr. Fu and Mr. Dykes.

The director slate proposed by management was elected at the Meeting. In addition, a series of stock option resolutions proposed by management was also passed; however, approximately 23 million votes for which Mr. Dykes held proxies were not counted for the motions related to the stock options.

The Claim

International Energy alleged that the results of the Meeting were invalid due to various legal deficiencies in the conduct of the meeting, including Mosquito's use of the Televote system to solicit proxies, and other voting irregularities at the Meeting.

International Energy sought a declaration that the Meeting was conducted in a manner oppressive or unfairly prejudicial to it and other members of the company, and it sought an order requiring Mosquito to convene a Special Meeting of the shareholders with conditions set by the Court.

Alternatively, International Energy sought a court order disallowing certain votes, including those obtained through Televote, and declaring the dissident slate of directors to be elected.

The Decision

The Court framed two of the issues as follows:

1) Was the use of the TeleVote system oppressive or unfairly prejudicial to International Energy, or in violation of the *Business Corporations Act*?
2) Were the other voting irregularities, in combination with the use of TeleVote, oppressive or unfairly prejudicial to International Energy?

Justice Fisher noted that International Energy sought relief under the oppression remedy provisions of the *Business Corporations Act* and summarized that "the test to be applied in a claim for oppression is two-pronged: (1) whether the evidence supports the reasonable expectation asserted by the petitioner, and (2) whether the evidence establishes that the reasonable expectation was violated by conduct falling within the terms "oppression" or "unfair prejudice" with respect to a relevant interest."

Upon reviewing relevant corporate and securities legislation, policies and guidelines, the Court held that:

> "The thrust of all of this legislation, policy and guidelines is to establish safeguards to ensure that proxies and voting instructions are provided by those having the authority to give them, and this requires that a reliable record is created contemporaneously in order to verify the information....My view is that TeleVote, as used by Georgeson in this case, was deficient in a number of ways, and it fell short of providing a contemporaneous, reliable and verifiable record of proxies and voting instructions."

The Court noted the following issues regarding the TeleVote system that was employed:

> "four issues regarding the TeleVote system employed by Georgeson:
>
> (a) the TeleVote system was not disclosed to shareholders and beneficial owners in Mosquito's Management Circular and Management Proxy as a way in which votes and voting instructions could or would be registered or tallied;
>
> (b) the method of using TeleVote is contrary to the allowable methods of voting explicitly set out by Mosquito itself in the Management Proxy;
>
> (c) Georgeson could not give a proxy to management for the shares purportedly voted through TeleVote because it did not have a proxy from CDS (via the proximate intermediaries); and
>
> (d) the TeleVote system lacked sufficient safeguards to ensure the accuracy or integrity of the process, and improperly blended the partisan solicitation of votes by one faction with the process of collecting and tallying votes and voting instructions and reconciling voting instructions with proxies."

Justice Fisher agreed with International Energy that there were a number of problems with the manner in which the Televote system was used for the Meeting including the following:

1) Mosquito's reliance on an oral grant of authority was insufficient;
2) there was no unique identifier when shareholders placed their votes which is a required "electronic signature" for regular telephone or internet voting;
3) there was no complete record of the oral grants of authority;
4) Mosquito relied on its proxy solicitation agent as agent for both management and shareholders to give and receive instructions which created a real potential for confusion;

5) there was a lack of disclosure as Televote was not mentioned in the management circular, the management proxy or any of Mosquito's subsequent news releases; and
6) there was a lack of sufficient safeguards to ensure that the votes were taken in a manner that allowed the shareholders to privately make their own choices on a fully informed basis, especially in the context of a contested vote.

In light of the foregoing, the Court found in favour of International Energy and in conclusion, commented that notwithstanding that efficiency is encouraged in respect of the means of sending information and electronic communication is expected, Televote "is something relatively new to the securities industry in Canada and it is important that the industry itself take steps to establish appropriate protocols for its use, particularly in contested meetings. With sufficient safeguards to ensure that proxies and voting instructions are properly given and shareholders have the freedom to vote as they choose, I expect it will become widely used in this jurisdiction to facilitate shareholder meetings."

Re K-Sea Transportation Partners L.P. Unitholder Litigation
C.A. No. 6301-VCP
Delaware Court of Chancery
April 4, 2012

Common unitholders of K-Sea Transportation Partners L.P., a publicly-traded Delaware limited partnership brought a class action claiming the limited partnership's Board had not adequately assessed the fairness of a $604 million acquisition by Kirby Corp. The Court found that the Board only had to consider whether the sale was in the partnership's best interests and dismissed the class action claims.

The Facts
K-Sea Transportation Partners L.P. (Partnership) was a publicly-traded Delaware limited partnership which operated a sea barge business. In March 2011, the Partnership entered into a merger agreement with a competitor, Kirby Corp. (Kirby) pursuant to which Kirby would acquire the Partnership's interests at a premium to its common units' trading price. The merger agreement also provided for a separate $18 million payment to the Partnership's general partner (General Partner) to acquire certain partnership interests it held exclusively.

To avoid a potential conflict of interest the board submitted the transaction to a conflicts committee comprised of independent directors who, relying on an investment bank's fairness opinion, determined that the overall transaction was fair and reasonable to the Partnership's common unitholders. On that basis, the full board approved the transaction which closed on July 1, 2011.

The Claim
The plaintiffs brought a class action on behalf of the Partnership's common unitholders making the following four claims:

1) that the conflicts committee members breached their fiduciary duties of care and loyalty by approving the merger agreement without specifically evaluating the fairness or reasonableness of the $18 payment to the General Partner;
2) that the General Partner and the board also breached the Partnership's limited partnership agreement by approving the merger agreement without evaluating the fairness of the $18 million payment;

3) that the General Partner and the board breached the limited partnership agreement by approving the merger agreement in reliance on the purposed, but ineffective, special approval of the conflicts committee comprised of members who improperly held phantom units; and
4) the General Partner and the board breached their fiduciary duty of disclosure by authorizing a Form S-4 (a form that must be submitted to the U.S. Securities and Exchange Commission in connection with a merger or an acquisition between two companies) which the plaintiffs claimed was materially misleading.

As the challenged merger transaction had already closed, the plaintiffs sought only money damages.

The defendants denied that the conflict committee's approval was defective and asserted that, in any event, neither the transaction nor the disclosures breached any contractual or fiduciary duty.

The Decision

Upon reviewing the Partnership's limited partnership agreement, the Court found that the limited partnership agreement established a contractual standard of review such that the General Partner and the board may be liable for money damages for a breach of the limited partnership agreement, or of any default fiduciary duty not eliminated by the limited partnership agreement, only if that breach resulted from an act or omission done in bad faith, and the General Partner is conclusively presumed to have acted in good faith if it relied on an expert it reasonably believed to be competent to render an opinion on the particular matter.

The Court noted that there was no allegation that the fairness opinion was outside of the professional competence of the financial advisor that delivered it.

Vice Chancellor Parsons also commented that notwithstanding that the conflicts committee was not the General Partner, "it would be unreasonable, even on a motion to dismiss, for the Court to infer that although an independent subset of the Board relied upon a fairness opinion, the entity that the Board manages did not rely upon that opinion. That is, the only reasonable inference from the allegations of the Amended Complaint is that K-Sea GP relied on a qualified expert's opinion."

The Court therefore reasoned that the limited partnership agreement provided the General Partner with a conclusive presumption that it acted in good faith in exercising its discretion to approve the Merger Agreement.

The Court accordingly determined that in order to survive the defendants' motions to dismiss, the plaintiffs had to plead facts that, if true, show that the defendants both:

1) breached the limited partnership agreement or a fiduciary duty; and

2) in doing so, acted in bad faith.

Bearing that standard in mind and reviewing the plaintiffs' claims of contractual and fiduciary breaches the Court concluded that the defendants' approval of the merger agreement did not constitute a breach of any contractual or fiduciary duty, regardless of whether the conflict committee's approval was effective.

Vice Chancellor Parsons also concluded that the implied covenant of good faith and fair dealing which cannot be waived in a limited partnership agreement was also

satisfied by the conclusive presumption provisions of the limited partnership agreement which effectively barred the plaintiffs' claims in this regard.

Finally, the Court also found that the disclosures authorized by the defendants were not materially misleading and therefore granted the defendants' motion to dismiss.

RAA Management, LLC. v. Savage Sports Holdings Inc.
Delaware Supreme Court
C.A. No. 11C-04-202
May 18, 2012

The Delaware Supreme Court affirmed an appeal from the decision of the Superior Court with respect to the legal effect to be given to "waiver" and "non-reliance" provisions contained in a confidentiality agreement. The Court rejected the potential purchaser's arguments that it should be able to recover due diligence costs and negotiating fees incurred in connection with the aborted transaction on the basis that the "waiver" and "non-reliance clauses" did not apply to "fraudulent inducement" by the potential vendor.

The Facts

Savage Sports Holdings, Inc. (Savage) is a United States rifle manufacturer. RAA Management LLC (RAA) is a Delaware based investment firm.

In September 2010, Savage's financial advisor, Robert W. Baird & Company (Investment Banker), solicited RAA about becoming a potential bidder to purchase Savage as Baird was conducting a private auction of Savage.

RAA explored the possibility of purchasing Savage and entered into a non-disclosure agreement with Savage (NDA) on September 17, 2010 in order to obtain confidential documents and information from Savage as part of RAA's due diligence process.

Pursuant to the NDA, RAA agreed to keep confidential all information furnished by Savage concerning Savage that was non-public, confidential or proprietary in nature. Moreover, the NDA contained "waiver" and "non-reliance" clauses pursuant to which RAA agreed that Savage was making no representations or warranties as to the accuracy or completeness of any information (Evaluation Material) being provided to RAA, and that Savage would have no liability to RAA resulting from RAA's reliance on such information, except for breaches of representations and warranties that Savage was to later make in an executed definitive sale agreement.

After reviewing the confidential information supplied by Savage, RAA ultimately determined to abort its pursuit of the transaction due to the discovery of significant unrecorded claims and liabilities notwithstanding that executives of Savage had denied the existence of such claims or liabilities prior to RAA's due diligence review of materials provided by Savage pursuant to the NDA.

The Claim

RAA sued to recover $1.2 million in due diligence costs and negotiating fees and expenses incurred in connection with the aborted transaction citing that had RAA been aware of the undisclosed claims and liabilities prior to commencing its due diligence efforts, RAA would not have incurred such fees and expenses.

The Decision

In hearing the case, the Court considered RAA's arguments that the "waiver" and "non-reliance" clauses did not apply to "fraudulent inducement" by Savage or information within the "peculiar knowledge" of Savage. The Court rejected these submissions and opined that among other considerations, sophisticated parties may not reasonably rely on representations made "outside" of an agreement where the NDA contained a provision that explicitly disclaimed reliance upon such "outside" representations or information.

In particular, the Court reviewed and gave effect to the "non-reliance" clause in paragraph 7 of the NDA which stated:

> "You [RAA] understand and acknowledge that neither the Company [Savage] nor any Company Representative is making any representation or warranty, express or implied, as to the accuracy or completeness of the Evaluation Material or of any other information concerning the Company provided or prepared by or for the Company, and none of the Company nor the Company Representatives, will have any liability to you or any other person resulting from your use of the Evaluation Material or any such other information. Only those representations or warranties that are made to a purchaser in the Sale Agreement when, as and if it is executed, and subject to such limitations and restrictions as may be specified [in] such a Sale Agreement, shall have any legal effect."

The Court also focussed on the "waiver" clause in paragraph 8 of the NDA which stated:

> "You [RAA] understand and agree that no contract or agreement providing for a transaction between you and the Company [Savage] shall be deemed to exist between you and the Company unless and until a definitive Sale Agreement has been executed and delivered, and you hereby waive, in advance, any claims . . . in connection with any such transaction unless and until you shall have entered into a definitive Sale Agreement."

In rejecting RAA's claim, the Court made the following observations:

1) the breadth and scope of the "waiver" and "non-reliance" clauses were defined by Savage and RAA in the NDA, which indicated that RAA was bound by those clauses as drafted;
2) the case involved two sophisticated parties who agreed that the potential purchaser could not rely upon or make a claim by reason of the due diligence information or any other information provided or prepared by or for Savage if the parties failed to reach a definitive sale agreement; and
3) sophisticated parties may not reasonably rely upon representations (including oral representations) made at the outset of negotiations where the NDA contains a provision explicitly disclaiming reliance upon such "other information" beyond the four corners of the Agreement, nor can these parties ignore the "waiver" provisions in the NDA.

For those reasons, Justice Holland affirmed the appeal from the decision of the Superior Court.

Martin Marietta Materials, Inc. v. Vulcan Materials Company
C.A. No 7102
Delaware Supreme Court
July 12, 2012

The Delaware Supreme Court affirmed an appeal from the Court of Chancery by upholding an injunction against Martin Marietta Materials, Inc. from pursuing a hostile take-over bid to acquire control of Vulcan Materials Company for a period of 4 months. The injunction had been initially issued by the Delaware Court of Chancery due to Martin Marietta Materials, Inc. breaching a non-disclosure agreement and a common interest, joint defense and confidentiality agreement relating to merger discussions with Vulcan Materials Company.

The Facts
Martin Marietta Materials, Inc. (Martin) and Vulcan Materials Company (Vulcan) are the two largest construction aggregates companies in the United States.

In early 2010, Martin and Vulcan's chief executive officers (CEOs) met to discuss the possibility of a consensual or friendly merger of the two companies.

The CEOs agreed that their discussions needed to remain confidential and that any information that the companies shared with one another would be used strictly for the purpose of evaluating and potentially consummating a friendly deal.

In particular, Martin's CEO was concerned about the possibility of a hostile acquisition by Vulcan or another party if their discussions were to be made public.

To move the discussions forward, the two companies executed two confidentiality agreements consisting of a Non-Disclosure Letter Agreement (NDA) and a Common Interest, Joint Defense and Confidentiality Agreement (JDA).

The NDA prohibited the use and disclosure of "Evaluation Material," being non-public information except where expressly permitted such as for the purpose of evaluating a possible business combination transaction between Martina and Vulcan.

The JDA dealt with "Confidential Materials" being privileged information that Martin and Vulcan exchanged for the purpose of jointly assessing potential antitrust implications of a merger transaction. The JDA stipulated that Confidential Materials were to be used solely for purposes of pursuing and completing the transaction.

Subsequent to a March 8, 2011 meeting between the parties, Martin and its bankers began using Vulcan's confidential, non-public information to consider alternatives to a friendly deal.

In particular, by April 2011, Martin's bankers began evaluating the constraints imposed by the NDA upon a non-consensual transaction and at an August 2011 meeting, Martin's board formally authorized management to pursue alternatives to a friendly deal which led to Martin launching an unsolicited exchange offer four months later.

Both before and after Martin commenced its hostile takeover bid, Martin disclosed non-public information about Vulcan, including in Martin's Form S-4 (a form that must be submitted to the U.S. Securities and Exchange Commission in connection with a merger or an acquisition between two companies) which disclosed not only the history of the negotiations but also other detailed Evaluation Material and Confidential Materials as defined in the NDA and JDA.

On December 12, 2011, being the day that Martin launched its hostile take-over bid with respect to Vulcan, Martin instigated a Court of Chancery action seeking a judicial declaration that nothing in the NDA barred Martin from conducting its exchange offer and proxy contest. Vulcan counterclaimed for a determination that Martin had breached the NDA and JDA.

The Decision

In affirming the Chancery Court's decision, Justice Jacobs noted the Chancellor's finding that:

> "Despite the Confidentiality Agreements, no effort was made to shield these advisors from receiving Evaluation Material or information relating to James' and Nye's negotiations. To the contrary, it is plain that the public relations advisors were given a blow-by-blow of Nye's and [Martin's CFO's] view of the negotiations with Vulcan and access to other Evaluation Material, and they advised Martin ... management how the process and substance of information sharing and negotiation could be translated into a public communications strategy that would exert pressure on Vulcan to accept an unsolicited bid from Martin ..."

The Court also noted that the trial court had also determined that certain provisions of the NDA, and all of the relevant provisions of the JDA, were unambiguous and independently precluded Martin from using and/or disclosing the JDA protected information.

The Court specifically repeated the Court of Chancery's findings that, although the NDA and JDA did not contain a "standstill" provision, they did bar Martin from doing the following:

1) "Using the broad class of 'evaluation material' defined by the confidentiality agreements except for the consideration of a contractually negotiated business combination transaction between the parties, and not for a combination that was to be effected by hostile, unsolicited activity of one of the parties;"
2) "Disclosing either the fact that the parties had merger discussions or any evaluation material shared under the confidentiality agreements unless the party was legally required to disclose because: (i) it had received 'oral questions, interrogatories, requests for information or documents in legal proceedings, subpoena, civil investigative demand or other similar process; and (ii) its legal counsel had, after giving the other party notice and the chance for it to comment on the extent of disclosure required, limited disclosure to the minimum necessary to satisfy the requirements of law;" and
3) "Disclosing information protected from disclosure by the confidentiality agreements through press releases, investor conference calls, and communications with journalists that were in no way required by law."

The Court also affirmed the Chancellor's findings that breaches of confidentiality agreements can cause irreparable harm that justify the granting of an enjoining order and that the four month period (which was tied to the expiration of the NDA) of the injunction order granted by the Court of Chancery was a reasonable length of time.

Canadian Securities Administrators Provide Guidance for Preparing and Filing an Offering Memorandum under National Instrument 45-106 Prospectus and Registration Exemptions

On April 26, 2012, the Canadian Securities Administrators (CSA) issued Multilateral CSA Staff Notice 45-309 – *Guidance for Preparing and Filing an Offering Memorandum* under National Instrument 45-106 *Prospectus and Registration Exemptions* (Staff Notice).

Background

National Instrument 45-106 *Prospectus and Registration Exemptions* (National Instrument) provides issuers with exemptions from the prospectus requirement for distributions of securities.

One of the popular exemptions that is available in all jurisdictions except Ontario is the Offering Memorandum Exemption set out in Section 2.9 of the National Instrument (OM Exemption).

Although an issuer's reliance on the OM exemption does not require prior approval as is the case for a distribution of securities pursuant to a prospectus, the use of the OM exemption is subject to regulatory oversight and monitoring.

Having observed a number of common deficiencies in offering memoranda that were purportedly prepared in accordance with Form 45-106F2 *Offering Memorandum for Non-Qualifying Issuers* (Offering Memorandum) (Form F2), the CSA published the Staff Notice to provide guidance to issuers and remind them of potential consequences of non-compliance.

Although the OM exemption is not available in Ontario, the guidance in the Staff Notice nevertheless applies to Ontario based issuers distributing securities in other CSA jurisdictions under the OM exemption.

Consequences of non-compliance

The CSA used the Staff Notice as an opportunity to remind issuers that failing to comply with the requirements set out in the National Instrument may result in a CSA regulator taking one or more of the following actions (depending on the nature and extent of the securities law breach):

- requiring the issuer to file a revised or amended document
- requiring the issuer to prepare and deliver an updated offering memorandum to existing purchasers
- requiring the issuer to grant rescission rights to certain investors
- imposing a cease trade order
- taking enforcement action

Issues identified by the CSA and Guidance

In the Staff Notice, the CSA outlined the following issues they observed with filed Offering Memorandums:

1. Failing to file an Offering Memorandum on time. The CSA noted that some issuers failed to file their Offering Memorandums within the 10 day period following the first distribution of securities.

2. Failing to update the Offering Memorandum when distributions are ongoing. The CSA observed that some issuers made distributions of securities relying on the OM Exemption but using a stale-dated Offering Memorandum. An Offering Memorandum can become stale dated if the certificate is no longer true or the included financial statements are out-dated.
3. Using an incorrect form of update. The CSA noted that some issuers failed to properly update their Offering Memorandums by preparing either an amendment to their existing Offering Memorandum or a new Offering Memorandum.
4. Failing to include sufficient information to make an informed investment decision. The CSA indicated that although an Offering Memorandum is generally not required to contain the level of detail and extent of disclosure required by a prospectus, it must still provide a prospective purchaser with sufficient information to make an informed investment decision.
5. Inadequately disclosing the issuer's business.
6. Failing to provide balanced disclosure. The CSA warned issuers that they should not present an unrealistic or excessively promotional picture of themselves to prospective purchasers in their Offering Memorandums.
7. Inadequately disclosing available funds and use of available funds. The CSA observed several types of inadequate disclosure in this area including: (i) some issuers stating that there were no commissions or offering costs whereas information contained elsewhere in the Offering Memorandum indicated otherwise; and (ii) issuers failing to include their existing working capital deficiency.
8. Inappropriately reallocating available funds. The CSA provided guidance to issuers that they must ensure prospective purchasers are provided with accurate and complete information with respect to how the issuer intends to use the available funds and that a statement indicating that funds may be reallocated is not a license to open-ended use of the funds.
9. Omitting key terms of material agreements.
10. Omitting compensation disclosure. The CSA reminded issuers that they must disclose compensation paid in the most recently completed financial year and anticipated to be paid in the current financial year to a director, officer, promoter and/or principal holder.
11. Inadequately disclosing management experience. The CSA commented that disclosure of management experience should not be overly promotional or generic in nature and should instead be specific enough for a prospective purchaser to evaluate management's background and ability to operate the issuer's business.
12. Disseminating material forward-looking information not included in the Offering Memorandum.
13. Omitting required interim financial reports.
14. Omitting key elements of financial statements. The CSA reminded issuers that the financial statements contained in an Offering Memorandum must be a full set of financial statements that comply with Canadian GAAP applicable to publicly accountable enterprises.
15. Failing to obtain required audits.
16. Omitting required audit reports or including non-compliant audit reports.

17. Inappropriately using a Notice to Reader. The CSA warned issuers that Offering Memorandums should not contain a "notice to reader" such as "Readers are cautioned that these financial statements may not be appropriate for their purposes" and it is the issuer's responsibility to ensure that the financial statements included in the Offering Memorandum comply with the Offering Memorandum requirements and are thereby appropriate for the purposes of the Offering Memorandum.
18. Failing to prepare financial statements in accordance with appropriate accounting principles.
19. Improperly certifying the Offering Memorandum.

Canadian Securities Administrators Provide Comments on Filings of Exempt Distribution Reports

On April 26, 2012, the Canadian Securities Administrators (CSA) issued CSA Staff Notice 45-308 – *Guidance for Preparing and Filing Reports of Exempt Distribution* under National Instrument 45-106 *Prospectus and Registration Exemptions*.

Background

Securities legislation precludes issuers and underwriters from distributing securities without a prospectus.

National Instrument 45-106 *Prospectus and Registration Exemptions* (National Instrument) contains a number of exemptions from the prospectus requirement and requires issuers and underwriters relying on certain prospectus exemptions to report the exempt distributions in a particular form (Exemption Form).

Issues identified by the CSA and Guidance

Responsibility for compliance with the National Instrument rests with the issuer or underwriter relying on the applicable exemptions; however, the use of a prospectus exemption under the National Instrument remains subject to regulatory oversight and monitoring by the CSA and the securities administrators review filings pursuant to compliance monitoring programs, observed market activity and as follow up to specific complaints or referrals.

In the Staff Notice, the CSA outlined the following observed issues with filed Exemptions Forms:

1. Issuers failed to use the correct form. One noted source of confusion is that there has recently been a specific form developed for use in British Columbia. If a distribution occurs in the province of British Columbia and elsewhere, the issuer or underwriter is required to file the British Columbia specific exemption form with the British Columbia Securities Commission and also file the Exemption Form with the relevant securities regulatory authority in all other applicable jurisdictions.
2. Issuers failed to file the Exemption Form in the required time period which is generally ten days after the distribution of securities.
3. Issuers failed to include a complete list of purchasers as required in the Exemption Form. If distributions are made in more than one jurisdiction, the issuer or underwriter must complete a single Exemption Form identifying all purchasers, including the purchasers that reside in the jurisdiction and those do not, and file that Exemption Form in each of the jurisdictions in which the distribution of securities is made.
4. Issuers incorrectly identified the total number of purchasers in each jurisdiction.

5. Issuers relied on unavailable exemptions. Some issuers that were distributing securities in more than one jurisdiction had reported securities distributions in their Exemption Forms specifying an exemption that is not available in all jurisdictions. For example, the family, friends and business associates exemption contained in Section 2.5 of the National Instrument is not available in Ontario even though Ontario offers a similar exemption in Section 2.7 of the National Instrument being the founder, control person and family exemption (applicable in Ontario only).
6. Issuers failed to disclose all commissions and finder's fees. The CSA observed that some issuers or underwriters were not reporting compensation paid in connection with a distribution, in some cases because the payments were not called a "commission" or a "finder's fee." The CSA reminded issuers and underwriters that the Exemption Form requires an issuer or underwriter to disclose compensation received or to be received by any person in connection with a distribution of securities and that compensation is a broad term including commissions, discounts or other fees or payments of a similar nature, which result from a distribution of securities, regardless of what the payment is called.
7. Issuers failed to provide complete information regarding convertible or exchangeable securities distributed. Complete information requires the inclusion of: (i) the description of the underlying security; (ii) the terms of conversion or exercise; and (iii) any expiry date.
8. Issuers improperly reported distributions under the $150,000 minimum amount exemption. The CSA also reminded issuers and underwriters that it is not permitted to distribute securities under the minimum amount exemption to multiple purchasers who are pooling their individual purchases to reach the $150,000 threshold.
9. Issuers failed to submit their Exemption Forms with properly signed certificates.

Ontario Securities Commission Conducts Emerging Market Review

On March 20, 2012, the Ontario Securities Commission (OSC) released Staff Notice 51-719 regarding its Emerging Markets Issuer Review (Staff Notice).

Background

Recognizing that the marketplace is becoming increasingly globalized and that emerging market issuers (EM Issuers) are important in both the global and Canadian marketplaces, the OSC commenced a regulatory review of EM Issuers to assess: (i) the quality and adequacy of selected EM Issuers' disclosure and corporate governance practices; and (ii) the adequacy of roles carried out by auditors, underwriters and exchanges.

EM Issuers Reviewed

The OSC selected and reviewed 24 EM Issuers which represented more than 50% of the EM Issuers for which Ontario is the principal regulator. All of the EM Issuers reviewed had operations in emerging market jurisdictions and were listed on Canadian exchanges. The EM Issuers were involved in a number of industries including mining, forestry, financial services, technology and clean energy.

General Concerns

In expressing its general concerns, the OSC identified four principal concerns from its review including:

- the inadequate level of EM issuer governance and disclosure;
- the adequacy of the audit function for an EM issuer's annual financial statements;

- the adequacy of the due diligence process conducted by underwriters in offerings of securities by EM Issuers; and
- The nature of the exchange listing approval process.

The OSC cited concerns with the extent of knowledge of boards and audit committees of the cultural and business practices of the jurisdictions in which the EM Issuers operated. In particular, the OSC observed that some EM Issuer boards did not appear to be aware of environmental factors that could have a significant impact on them, such as banking practices, currency restrictions and the regulatory and legal environment specific to the industry in which the EM Issuers operated.

With respect to risk management and internal controls, the OSC specifically noted risks that may not have been appropriately identified, understood or managed by boards of EM Issuers including risks related to:

- political factors, such as government instability and changing governmental policy that may affect legal rights, such as property ownership;
- the legal and regulatory framework, given that emerging market jurisdictions may have less developed legal or regulatory systems;
- the movement and conversion of currency out of the foreign jurisdiction, which could hinder the repatriation of profits to Canadian investors; and
- legal title to assets.

The OSC also found that risk disclosures by some EM Issuers were not as specific or relevant as they should have been to be helpful and informative to investors.

Auditors

The OSC identified several areas of potential concern with respect to the way in which the external audit function was performed for EM Issuers.

In particular, the OSC was concerned that auditors may not have performed sufficient procedures in some instances to understand and appropriately scrutinize the information provided to them by an issuer and/or foreign 'component' auditor.

Moreover, the OSC expressed its opinion that the level of professional scepticism exhibited by auditors when examining the information gathered in the course of their audit was generally lacking. The OSC is concerned that in some instances auditor simply accepted management's representations at face value and did not perform sufficient alternative procedures to independently verify the information they received.

The OSC also indicated a lack of confidence in the auditors' knowledge of local cultural and business practices. As an example, if checklists were prepared, the OSC found it questionable that responses resulted in sufficient understanding of the cultural and business practices of the jurisdictions in which the issuer operated.

Underwriters

The OSC expressed its view that underwriters are uniquely situated to verify information about an issuer, its operations and management and act as gatekeepers of securities markets.

Having reviewed the work of underwriters in the public offerings of securities by selected EM Issuers, the OSC raised concerns about the following:

- variations in due diligence practices (e.g. some underwriters provided internal policies and due diligence procedures and practices whereas other underwriters had limited processes);
- inadequate levels of professional scepticism and rigor; and
- inadequate levels of due diligence documentation.

Exchanges

Although the OSC recognized that Exchanges have supplemental procedures and policies geared to EM Issuers, it expressed its view that a re-examination of the sufficiency of such procedures and policies may be warranted in light of the heightened risks associated with emerging markets.

Recommendations and Next Steps

Based on its findings, the OSC made numerous recommendations for EM issuers, Auditors and Exchanges including: (i) establishing guidance to improve corporate governance practices, particularly in the areas related to the responsibilities of the board and its committees to understand the business, operating environment and risks for issuers whose principal operations are in foreign jurisdictions; (ii) requiring better disclosure to investors of complex corporate structures and their purpose; (iii) requiring better explanations of risk factors relevant to EM Issuers; (iv) raising investor awareness of risks associated with investments in issuers whose principal operations are in foreign jurisdictions; (v) establishing a consistent and transparent set of requirements for the conduct of due diligence by underwriters; (vi) assess whether additional listing requirements are needed for EM Issuers to address specific risks associated with them, or if additional exchange review procedures are required to assess if significant risks are present and how those risks could be addressed; and (vii) assessing whether the extent of reliance on third parties in conducting due diligence is appropriate in the listings process or whether additional due diligence steps are warranted.