



There have been important developments with respect to take-over bids in recent months. Over the same period, we have seen a strong affirmation of the business judgment rule and a finding with respect to the duty of majority shareholders to minority shareholders.

Take-Over Bids: the Bid for Sears Canada

In December 2005, US based parent Sears Holdings, owning 52 per cent of Sears Canada, launched a take-over bid to acquire the remaining shares of its Canadian subsidiary. As the holder of over 10 per cent of Sears Canada's common shares, the bid was an insider bid regulated under OSC Rule 61-501 *Insider Bids, Issuer Bids, Business Combination and Related Party Transactions*.

Three US funds with investments in Sears Canada complained to the Ontario Securities Commission regarding the manner in which Sears Holdings was conducting its offer. In particular, the funds alleged that Sears Holdings had entered into impermissible arrangements with certain shareholders holding large blocks of Sears Canada in order to secure the level of shareholder support necessary to compulsorily squeeze-out shareholders that did not wish to accept Sears Holdings' offer. These dissident funds also alleged that the take-over bid circular for the offer contained misrepresentations and that the offer was being conducted in an abusive and coercive manner.

The OSC held a three day hearing to investigate the allegations of the dissidents, as well as those of Sears Holdings with respect to the activities of the dissidents in opposing the bid.

The OSC held that the arrangements Sears Holdings had made with certain major shareholders to secure their votes in order to privatize Sears Canada violated the requirement under the *Securities Act* (Ontario) to provide all holders of securities subject to a take-over bid with identical consideration. It also held that the circular for the bid did not provide adequate disclosure regarding the arrangements Sears Holdings had made, and that elements of the conduct of the bid was coercive and abusive (for example, the OSC was critical of the manner in which Sears Holdings dealt with the special committee of directors of Sears Canada responsible for making a recommendation regarding the bid).

The OSC's order prohibited the votes of certain shareholders Sears Holdings had secured to support its bid from being included in the calculation required under

Rule 61-501 to compulsorily acquire shares not tendered to the bid and required Sears Holdings to address disclosure deficiencies in its bid circular. The order effectively stopped the bid.

Sears Holdings appealed the OSC's decision to the Ontario Divisional Court. The Divisional Court upheld the OSC's decision. Sears Holdings then sought leave to appeal the ruling of the Divisional Court to the Ontario Court of Appeal. The Court of Appeal declined to hear the appeal and the bid expired with Sears Holdings having failed to secure the shareholder support necessary to acquire all of Sears Canada.

A number of important conclusions can be drawn from Sears Holdings' failed attempt to privatize Sears Canada.

- The restructuring of an offer after it has commenced will be problematic if it involves arrangements only for certain shareholders.
- The OSC will review the context of disclosure in a transaction to determine whether it is satisfactory in the circumstances, indicating that minimal adherence to form requirements may not be enough to satisfy disclosure obligations.
- In an insider bid the offeror should be careful that it gives the proper, required assistance to the target's special committee reviewing the bid.
- The Divisional Court will give strong deference to the OSC's exercise of its public interest jurisdiction.

Take-Over Bid Defences: Poison Pills

Shareholder rights plans (or unitholder rights plans in the case of income trusts) are often justified as tools to prevent "creeping" take-overs, being acquisitions of public companies by means of securing a blocking position which effectively eliminates the possibility of another bidder (or bidders) making an offer for the company. In its decision in *re Falconbridge*, the OSC seems to have given its support to boards trying to prevent these situations.

In August 2005, Xstrata acquired from Brascan a 19.9 per cent interest in Falconbridge (created through the merger of Falconbridge and Noranda), and thereafter proposed a possible combination of itself and Falconbridge. Xstrata's discussions with Falconbridge did not conclude in a transaction, and instead, in

October 2005, Falconbridge entered into an agreement to be acquired by Inco. Inco's offer was extended several times while it pursued regulatory approval for the acquisition.

In May 2006, Xstrata launched its own unsolicited offer for Falconbridge. Xstrata's offer was not a "permitted bid" under Falconbridge's shareholder rights plan. As a result, in the event Xstrata acquired 20 per cent or more of Falconbridge as a result of its offer, Falconbridge's rights plan would have operated to dilute Xstrata's interest in Falconbridge. In contrast, Inco's still outstanding offer was a permitted bid under Falconbridge's shareholder rights plan.

Xstrata applied to the OSC to terminate Falconbridge's shareholder rights plan. Falconbridge countered with its own application to the OSC, seeking a prohibition on Xstrata acquiring any more shares in Falconbridge until it amended its offer to become a permitted bid. Pursuant to applicable take-over bid rules, Xstrata could have purchased an additional 5 per cent of Falconbridge's shares outside of its bid, thereby increasing its stake to almost 25 per cent. At that level, Falconbridge submitted to the OSC, Xstrata would be in a position to block any other offers for Falconbridge, particularly Inco's bid, thereby eliminating the potential benefits to Falconbridge's shareholders of an auction for the company.

Before the OSC hearing, Phelps Dodge, Inco and Falconbridge announced that they had agreed to combine. As part of the combination, Inco agreed, with Phelps Dodge's assistance, to raise its offer price for Falconbridge and to extend the time for acceptance of its bid.

The OSC concluded that it was in the best interests of Falconbridge's shareholders that the auction between Xstrata and Inco be allowed to continue for an additional period after the hearing, and therefore allowed Falconbridge's shareholder rights plan to remain in place for a period of time. The OSC also prohibited Xstrata from utilizing the 5 per cent acquisition exemption until the earlier of the date that Xstrata had met its minimum tender condition under its offer or the date Falconbridge's shareholder rights plan was terminated.

In the end, Xstrata raised its bid and acquired Falconbridge.

In *re Falconbridge*, the OSC demonstrated its willingness to allow rights plans to fulfill the purpose of giving stakeholders options in the face of unsolicited take-over bids. In its decision in *re Inco Limited and Tech Cominco Limited*, which was issued soon after its decision in *re Falconbridge*, the OSC clearly stated its policy towards rights plans as follows:

"Unrestricted auctions produce the most desirable results

in take-over contests. In the case law, the Commission makes it clear that rights plans are tolerated, not promoted, and then only to the extent that they allow a board of directors of the target company to fulfill its fiduciary duty – for example, to seek out a better bid to which shareholders may choose to tender their shares."

Take-Over Bids: Pending Regulations

Proposed Multilateral Instrument 61-101 *Protection of Minority Security Holders in Special Transactions* is primarily designed to harmonize the requirements governing insider bids, issuer bids, business combinations and related party transactions in Quebec and Ontario, which are currently regulated under Regulation Q-27 and OSC Rule 61-501, respectively.

The proposed instrument also contains changes to the current provisions under Rule 61-501. One of these changes is the inclusion of service agreements with related parties in the definition of "related party transaction". As a result of this change, issuers that retain the services of a related party or provide services to a related party must obtain the approval of minority security holders unless an exemption is otherwise available. Another change is a new prohibition against independent directors receiving a benefit that is not generally available to security holders as a consequence of a transaction, such as a "success fee" to independent directors upon the completion of a transaction.

Proposed National Instrument 62-104 *Take-Over Bids and Issuer Bids* introduces a harmonized take-over bid and issuer bid regime across Canada (for example, the use of specified forms for take-over bid and directors' circulars). One of the intended purposes of the proposed instrument is to codify discretionary exemptions that have routinely been granted by securities commissions (for example, with respect to offers of employment by bidders to managements of target issuers).

The proposed instrument also contains changes to current take-over bid rules. An important change is the addition of restrictions to the variations to the terms of an offer that an offeror is permitted to make after a bid is commenced. Under the proposed instrument, once it has commenced its bid, the offeror will not be able to lower the consideration under the bid, change the form of consideration, lower the proportion of outstanding securities for which the bid is made or add new conditions to the bid.

The proposed instrument also clarifies the availability of the "private agreement" exemption to the take-over bid rules, which allows offers to purchase to be made to no more than 5 persons at no more than a specified premium to the market price. The proposed instrument stipulates that the exemption can only be utilized once in

relation to an offeree issuer, thereby prohibiting the use of the exemption a number of times in order to avoid the application of the take-over bid rules.

The public comment periods for proposed instruments 61-101 and 62-104 are now closed. The expectation is that these instruments will be enacted in the new year.

Business Judgment Rule

The business judgment rule is a principle of judicial deference to decisions of boards of directors taken in good faith and prudently that are “within a range of reasonableness”.¹

In *McEwen v. Goldcorp Inc.*, Robert McEwen, the former Chief Executive Officer of Goldcorp and the holder of approximately 1.5 per cent of its outstanding common shares, applied to the Ontario Superior Court for, among other things, an order requiring Goldcorp to seek shareholder approval for its proposed acquisition of Glamis Gold. The acquisition was structured as a plan of arrangement for Glamis under the *Business Corporations Act* (British Columbia) pursuant to which Glamis shareholders would exchange their shares for an approximate 40 per cent interest in Goldcorp. The plan of arrangement provided for approval of the transaction by Glamis shareholders, but not by Goldcorp shareholders.

Justice Pepall held that the structure of the acquisition was such that the transaction was not subject to the arrangement provisions of the *Business Corporations Act* (Ontario), Goldcorp’s governing statute, and therefore did not require the approval of Goldcorp’s shareholders.

McEwen had also asked the court to find that the transaction was oppressive to Goldcorp’s shareholders. In rejecting that finding, Justice Pepall examined the process that Goldcorp’s board undertook in formulating the transaction to acquire Glamis, and found that it was within the range of reasonableness to not seek the approval of Goldcorp’s shareholders for the transaction.

Goldcorp’s board identified “deal certainty” as an important factor in coming to its determination not to seek approval from its shareholders - it was important to Glamis that it could rely on Goldcorp to be committed to the acquisition, and that this commitment could not be threatened by the possibility of a lack of shareholder support. *McEwen* will now clearly stand for the proposition that directors can agree to transactions without going to their shareholders for approval, absent an explicit legal requirement to do so.

Justice Pepall’s decision was upheld by the Ontario Divisional Court.

Majority Shareholder Duty

Greenlight Capital Inc. v Stronach was an Ontario oppression case involving a partially-owned public subsidiary of Magna, MI Developments, and certain associates of MI Developments, including directors who formed a special committee of the company’s board.

In October 2004, Greenlight proposed a restructuring of MI Developments which included the elimination of its dual class share structure, a spin-off of its interest in Magna Entertainment Corporation and the conversion of MI Developments into a real estate investment trust. A special committee of the board and the board of MI Developments rejected Greenlight’s proposals. At the company’s annual and special meeting of shareholders, Greenlight’s proposals were defeated. Greenlight argued that Frank Stronach’s votes against the proposals constituted oppressive conduct.

The extent of the obligation of a majority or controlling shareholder to exercise its votes with a view to the interests of minority shareholders has been the subject of some speculation.² In *Greenlight*, Justice Ground held that a majority shareholder was only subject to a “very narrow restriction” in voting its shares in its own interest - the vote of the majority shareholder must reflect what the shareholder honestly believes to be in the best interest of the corporation or the shareholders as a whole, and thereby not amount to a “fraud on the minority”.

In holding that Stronach’s voting against Greenlight’s proposals was not oppressive, Justice Ground found that shareholders of MI Developments could not reasonably have expected Stronach to vote otherwise than against the proposals. He had always maintained his support of MI Development’s business plan, which clearly would mean that he did not favour the reorganization advocated by Greenlight. Without reasonable expectation there could be no oppression.

In the action, Greenlight alleged that the failure of MI Developments to follow certain of its established corporate governance policies and procedures was oppressive as well. In rejecting Greenlight’s claim, Justice Ground held that “a court is not required to do a microscopic examination of a committee or a board’s processes and proceedings,” and that there was no evidence that the failure of the special committee or board of MI Developments “in certain circumstances to comply scrupulously in all respects with such corporate governance practices or policies” resulted in the directors not fulfilling their obligations.

¹ *Maple Leaf Foods Inc. v. Schneider* (1998)

² *Benson v. Third Canadian General Investments Trust* (1993)

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<i>Name</i>	<i>Direct Line</i>
Rory Cattnach	(416) 361-4766
Perry Dellelce	(416) 361-5899
Vaughn MacLellan	(416) 361-2932
Charlie Malone	(416) 361-1267
Troy Pocaluyko	(416) 361-5802
Derek Sigel	(416) 361-4775
Mark Wilson	(416) 361-4763
Rob Wortzman	(416) 361-2930

Wildeboer Dellelce LLP

wildlaw.ca



Suite 800
Wildeboer Dellelce Place
365 Bay Street
Toronto, Ontario
M5H 2V1

72 Victoria Street South
Suite B2
Kitchener, Ontario
N2G 4Y9

Phone: (416) 361-3121
Facsimile: (416) 361-1790

Phone: (519) 741-8708
Facsimile: (519) 741-9576