Dalhousie Law Journal

Volume 7 | Issue 3 Article 3

10-1-1983

The Take-Over Bid by Private Agreement: The Follow-Up Offer Obligation

Bruce Bailey

Purdy Crawford

Recommended Citation
Bruce Bailey & Purdy Crawford, "The Take-Over Bid by Private Agreement: The Follow-Up Offer Obligation" (1982-1983) 7:3 DLJ 93.

Bruce Bailey and
Purdy Crawford*

The Take-Over Bid by Private Agreement: The Follow-Up Offer Obligation

I. *Introduction*

The acquisition of control of a public corporation by the private purchase of shares from a controlling shareholder[1] or a control group has been one of the most controversial issues in corporate and securities law and has been the subject of a continuing debate.[2] The purchase of corporate control raises the fundamental issue of the extent to which a controlling shareholder should be permitted to dispose of his shares at a premium without sharing the premium with minority shareholders. Securities law in the United States does not require equal treatment where control is acquired by private agreement,[3] but some American jurisprudence holds, as a matter of

*Of Osler, Hoskin and Harcourt, Barristers and Solicitors, Toronto.

1. The reference to the acquisition of control by the purchase of shares implies that the issue only relates to voting shares. The Ontario follow-up offer obligation does, in fact, only relate to voting shares. However, under the theory that control is a corporate asset, or, to a lesser extent, under the theory that the holder of control has a fiduciary duty to the other shareholders, the sharing of a control premium would not necessarily be limited to voting shareholders. See section II of this paper.
2. See section II of this paper.
3. See Humes, *Private Solicitations Under the Williams Act* (1981), 66 Cornell L. Rev. 361. See also Block and Schwarzfeld, *Curbing the Unregulated Tender Offer* (1978), 6 Sec. Reg. L.J. 133 and "Proposed Amendments to Tender Offer Rules" (1979), 18 SEC DOCKET, (No. 17) 1092. The Securities and Exchange Commission Advisory Committee on Tender Offers (the "SEC Tender Offer Committee") has considered, inter alia, the issues relating to the regulation of the acquisition of corporate control. See *Advisory Committee on Tender Offers Report of Recommendations* (U.S. Securities and Exchange Commission, Washington D.C., July 8, 1983), SEC Release No. 1028 Fed. Sec. L. Rep. (CCH) Special Report (July 15, 1983). The SEC Tender Offer Committee advised in Recommendation 14 that: "No person may acquire voting securities of an issuer, if, immediately following such acquisition, such person would own more than 20 percent of the voting power of the outstanding voting securities of that issuer unless such purchase were made (i) from the issuer, or (ii) pursuant to a tender offer. The Commission should retain broad exemptive power with respect to this provision." The SEC Tender Offer Committee did not, however, suggest guidelines for the exercise of the "broad exemptive power" and did not give reasons for the suggested prohibition of a stock exchange bid where greater than 20 percent of voting securities of an offeree were to be acquired.

corporate law, that majority shareholders who sell effective control of a corporation at a premium are under a duty to share the premium with the remaining minority shareholders, essentially on the ground that majority shareholders owe a fiduciary duty to the minority.[4]

---

4. See, for example, *Perlman* v. *Feldmann* 219 F.2d 173 (U.S.C.A. 2d Cir., 1955), *cert. denied,* 349 U.S. 952 (1955); *Jones* v. *H.F. Ahmanson & Co.* 460 P. 2d 464 (Cal. S.C. 1969). But see, for example, *Honigman* v. *Green Giant Co.* 309F.2d 667 (U.S.C.A. 8th Cir., 1962), at p.670 (rejection of Berle's theory that control is a corporate asset). See also, Comment, *Shareholders' Liability for Sale of Controlling Interest* (1955), 22 U. Chi. L. Rev. 895; Note, (1970), 70 Colum. L.R. 1079; and Note, (1969), 83 Harv. L. Rev. 1904.

Perlman has been cited as supporting the view that control is a corporate asset that belongs to all shareholders. See, for example, Berle, *"Control" in Corporate Law* (1958), 58 Colum. L. Rev. 1212 at p. 1220. In *Perlman,* the president, chairman, and majority shareholder sold effective control of a steel corporation to a syndicate of steel users which had organized to acquire control of a dependable source of steel supply. Minority shareholders brought a derivative suit, arguing that the price paid for the control block included compensation for a corporate asset — namely, the power or ability to control the allocation of the corporation's product in a time of short supply. The court held the sellers liable to the minority shareholders for that portion of the purchase price attributable to "the appurtenant control over the corporation's output of steel" (219 F.2d at p.178). The court further stated (at p.178) that it did not mean to:

> . . .suggest that a majority stockholder cannot dispose of his controlling block of stock to outsiders without having to account to his corporation for profits or even never do this with impunity when the buyer is an interested customer, actual or potential, for the corporation's product. But when the sale necessarily results in a sacrifice of this element of corporate good will and consequent unusual profit to the fiduciary who has caused the sacrifice he should account for his gains. So in a time of market shortage, where a call on a corporation's product commands an unusually large premium, in one form or another, we think it sound law that a fiduciary may not appropriate for himself the value of this premium.

Thus, the *ratio* of *Perlman* might arguably relate more to a diversion of corporate opportunities, rather than the sale of control as a corporate asset per se. Leech comments that ". . .by its requirement that defendant show the value of their shares shorn of the power to allocate steel, the court made it quite clear that the presence of misappropriated opportunity was the essential element in determining their liability." See Leech, *Transactions in Corporate Control* (1956), 104 U. Pa. L. Rev. 725 at p.815.

In *Jones,* a successful minority shareholders' action was brought against a former holding company which had sold control. Traynor C.J. stated at p.471 that:

> . . .majority shareholders, either singly or acting in concert to accomplish a joint purpose, have a fiduciary responsibility to the minority and to the corporation to use their ability to control the corporation in a fair, just, and equitable manner. Majority shareholders may not use their power to control corporate activities to benefit themselves alone or in a manner detrimental to the minority. Any use to which they put the corporation or their power to control the corporation must benefit all shareholders proportionately. . . .

Notwithstanding some Canadian judicial recognition of a fiduciary duty of the majority to the minority shareholders where corporate control is sold,[5] there has not been a parallel development in Anglo-Canadian jurisprudence where it has generally been assumed

5. See *Farnham* v. *Fingold,* [1973] 2 O.R. 132 (C.A.), (1973) 33 D.L.R. (3d) 156; revg., on other grounds, [1972] 3 O.R. 688 (H.C.J.), (1972), 29 D.L R. (3d) 279, (recognition, as a legitimate cause of action, of a suit predicated on the existence of a fiduciary obligation owed to all shareholders by a control group in the sale of their controlling shares at a premium in an interlocutory proceeding settled before trial; the issue before the C.A. dealt simply with whether there was a proper class action). See also *Re R.J. Jowsey Mining Co. Ltd.,* [1969] 2 O.R. 549 (C.A.), (1969), 6 D.L.R. (3d) 97, *(per* Laskin J.A., as he then was, in a dictum at O.R., pp. 556-557, stating that ". . .the taking of control of a public company itself lays a burden of fair dealing on the person or group who secures it, beyond any duty that devolves upon them as directors in the day to day operations of the company"); *Re Consolidated Manitoba Mines Ltd.,* [December 1966] O.S.C.B. 5, (per the then Chairman, J.R. Kimber, and Commissioners J.H. McFarland and John Willis observing that the question of sharing a control premium was a matter of corporate law, but intervening to refuse to allow a transfer of shares within escrow where the transfer would pass control to purchasers without a take-over bid being made for the minority shares, stating at p.10 that "[a]s to a shareholder's right to equal opportunity, the Ontario law may not be settled on this question but it is recognized as good corporate practice to provide this . . . . Indeed it is just because the law is not clear that the Commission feels impelled . . . to extend its protection to the shareholders . . . . in so doing the Commission is trying to carry out the spirit of the law.")

Consolidated Manitoba Mines was referred to in *Brown* v. *Halbert,* 76 Cal. Rptr. 781 (Ct. App. 1st Dist., 1969) (breach of fiduciary duty established where sale of only controlling shareholder's shares to purchaser offering to buy assets of corporation or all shares). After *Consolidated Manitoba Mines,* the OSC attempted to require that purchasers of control shares held in escrow make an offer to all other shareholders. See "Proposed Policy Change: Consents to Transfer Within Escrow", [May 1967] 1 O.S.C.B. 1 at pp.1-2:

> Since [the *Consolidated Manitoba Mines* decision] The Securities Act, 1966 has been proclaimed and is now fully in force. On considering requests for transfers within the escrow of numbers of shares of mining companies issued for properties which are sufficiently large to materially affect control, the Commons concluded that it would be inequitable to permit the sale and transfer of those shares unless a similar offer is made to all the shareholders of the offeree company. The Commission is of the view that where an offer to purchase is made to the holders of escrowed shares a similar offer should be made to all shareholders following the standards of disclosure and the conditions laid down for take-over bids by Part IX of The Securities Act, 1966.

Later, the OSC stated that transfers in escrow would be approved if it could be demonstrated that they were, inter alia, "of benefit to all shareholders generally." See "Re: Transfers Within Escrow", [1967] 2 O.S.C.B. 72. See also *Re Terra Riche Mines Limited,* [1967] 2 O.S.C.B. 73. The OSC did not, however, extend its escrow share policy to other transactions. See, for example, *Re Wainoco Oil and Chemicals Limited,* [1967] 2 O.S.C.B. 97. See generally, Gibson, *The Sale of Control in Canadian Company Law* (1975), 10 U.B.C. Law Rev. 1 at p.12, n.34.

that majority shareholders and directors will not breach a fiduciary duty toward minority shareholders simply because they have either sold or sanctioned the sale of a controlling block of shares at a premium not available to the other shareholders.[6]

After considerable debate in Ontario, the question of an equal opportunity for minority shareholders to share in a premium paid for control was addressed in The Securities Act, 1978, which enacted a shareholder equal opportunity law, commonly referred to as the "follow-up offer obligation".[7] In general terms, the act requires that a purchaser who acquires publicly traded voting shares of a public corporation in a private agreement transaction which would normally be regulated by the act as a take-over bid and who pays a price exceeding fifteen percent of the trading price must make a follow-up offer of equivalent value to the remaining shareholders.[8] Manitoba has adopted the follow-up offer obligation in its securities

6. Gower, L.C.B., Cronin, J.B., Easson, A.J., and Lord Wedderburn of Charlton, *Gower's Principles of Modern Company Law* (4th ed., London: Stevens & Sons, 1979) p. 707. *Gower's* does, however, state at p. 640 that "[w]e may, indeed, be approaching the view taken by a number of American courts, that members who sell shares which confer effective control of the company and, in consequence, command a higher price are under a duty to share the excess price with the other shareholders". See also, Iacobucci, Frank, Pilkington, Marilyn L., and Prichard, J. Robert S., *Canadian Business Corporations* (Agincourt: Canada Law Book Limited, 1977) pp. 445-466; Beck, Stanley M., Getz, Leon, Iacobucci, Frank, and Johnston, David L., *Business Associations Casebook* (Toronto: Richard De Boo Limited, 1979) pp.356-391; *Short* v. *Treasury Commissioners*, [1948] A.C. 534 (H.L.), per a dictum of Lord Uthwatt at p.546: ". . .if some one shareholder held a number of shares sufficient to carry control of the company, it might well be that the value proper [sic] to be attributed to his holding. . .was greater than the sum of values that would be attributed to the shares comprised in that holding if they were split between various persons. The reason is that he has something to sell — control — which the others considered separately have not."

7. The Securities Act, 1978, S.O. 1978, c.47, as am. by S.O. 1979, c.86 (in force on September 15, 1979), now the Securities Act, R.S.O. 1980, c.466 (hereinafter referred to as the "act"). The regulation under the act (hereinafter referred to as the "regulation") is R.R.O. 1980, Reg. 910, as am. by O.Reg. 84/81, O.Reg. 224/81, O.Reg. 238/81, O.Reg. 637/82, O.Reg. 649/82, O.Reg. 808/82, and O. Reg. 180/83.

8. See section III of this paper.

See generally, Alboini, Victor P., *Ontario Securities Law* (Toronto: Richard De Boo Limited, 1980) pp. 716-732; Anisman, Philip, *Takeover Bid Legislation in Canada: A Comparative Analysis* (Don Mills: CCH Canadian Limited, 1974) pp. 37-44; Johnston, David L., *Canadian Securities Regulation* (Toronto: Butterworths, 1977) pp.324, 340-341, and Johnston, D.L., Buckley, F.H., Dey, P.J., and Drinkwater, D.W., *Canadian Securities Regulation Supplement 1982* (Toronto: Butterworths, 1982) pp.46 and 53.

legislation, which has not yet been proclaimed in force,[9] and British Columbia's draft proposals for new securities legislation include the follow-up offer obligation.[10] In Quebec, the new Securities Act removes the private agreement exemption where the offeror pays in excess of a fifteen percent premium over the market price, requiring all bids at an amount above the premium to be made pro rata.[11] The follow-up offer obligation was not included in Alberta's revised securities legislation[12] and the Canada Business Corporations Act does not include a follow-up offer obligation.[13] The draft proposals

---

9. The Securities Act, 1980, S.M. 1980, c.50, subs. 91(1).

10. *A Proposed New Securities Act and Draft Regulations* (Ministry of Consumer and Corporate Affairs, British Columbia, July 1982) Draft Reg., s.137.

11. Securities Act, S.Q. 1982, c.48, s.116 and Q.Reg. 83-660, s.187.

12. Securities Act, 1981, S.A. 1981, c. S-6.1, as am. by S.A. 1982, c.32.

13. Canada Business Corporations Act, S.C. 1974-75, c.33, as amended (hereinafter referred to as the "CBCA"). There may be a question as to whether the Parliament of Canada has the constitutional authority to enact a follow-up offer obligation in the CBCA. Since the provisions in the CBCA relating to take-over bids are only operative when the target corporation is a CBCA corporation, we believe that such an amendment to the CBCA would be intra vires the Parliament of Canada.

Section 92(11) of the Constitution Act, 1867 (formerly the B.N.A. Act) confers on the provincial legislatures the power to make laws in relation to "the incorporation of companies with provincial objects". Although a corresponding power is not included in the enumeration of federal powers contained in s.91 of the act, the legislative jurisdiction of Parliament in relation to the incorporation of companies with other than provincial objects has long been recognized by Canadian courts. The nature and extent of this jurisdiction, which has often been the subject of considerable controversy in the courts, was recently considered by Dickson J. in *Multiple Access Ltd.* v. *McCutcheon* (1982), 44 N.R. 181 (S.C.C.), where, speaking on behalf of the court, he stated, at p.197, that:

> It has been well established ever since *John Deere Plow Company Ltd.* v. *Wharton*, [1915] A.C. 330 (P.C.), that the power of legislating with reference to the incorporation of companies with other than provincial objects belonged exclusively to the Dominion Parliament as a matter covered by the expression "the peace, order and good government of Canada". Additionally, the power to regulate trade and commerce, at all events, enabled the Parliament of Canada to prescribe to what extent the powers of companies the objects of which extended to the entire Dominion should be exercisable and what limitations should be placed on such powers. Viscount Haldane, L.C., delivering the judgment of their Lordships, stated further (at p.340) that ". . .if it be established that the Dominion Parliament can create such companies, then it becomes a question of general interest throughout the Dominion in what fashion they should be permitted to trade".
>
> The power of Parliament in relation to the incorporation of companies with other than provincial objects has not been narrowly defined. The authorities are clear that it goes well beyond mere incorporation. It extends to such matters as the maintenance of the company, the protection of creditors of the company and

for a federal securities market law did not include a follow-up offer obligation, and the issue was left "for reconsideration in light of the

---

the safeguarding of the interests of the shareholders. It is all part of the internal ordering as distinguished from the commercial activities . . . As Professor Hogg has said in his book [*Constitutional Law of Canada* (1977)] at p.351: "The federal power to incorporate companies . . . is simply the residue of the entire possible power to incorporate companies after subtracting the provincial power" and ". . .it also authorizes all laws of a company law character, for example, the laws pertaining to corporate powers, organization, internal management and financing" (at p. 353).

The issue to be considered, therefore, is whether the proposed amendments would fall within this federal "company law" power. The leading case on point is *Esso Standard (Inter-America) Inc.* v. *J.W. Enterprises Inc.*, [1963] S.C.R. 144, where the Supreme Court of Canada was asked to consider the constitutional validity of the provisions of The Companies Act, 1952, R.S.C. 1952, c. 53 s. 128 (the corresponding provision in the CBCA is subs. 199(3)), respecting the compulsory acquisition of minority shares in take-over bids. Judson J., speaking on behalf of the court, stated, at 152-153, that:

> There has been complete unanimity throughout [the course of the litigation] that Parliament has the power to enact section 128. The matter was summarized by Laidlaw J.A. [speaking on behalf of the Ontario Court of Appeal] as follows: "It is my opinion that the Parliament of Canada having legislative power to create companies whose objects extend to more than one Province possesses also the legislative power to prescribe the manner in which shares of the capital of such companies can be transferred and acquired. That matter is one of general interest throughout the Dominion." It is truly legislation in relation to the incorporation of companies with other than provincial objects and it is not legislation in relation to property and civil rights in the province or in relation to any matter coming within the classes of subject assigned exclusively to the legislature of the province. It deals with certain conditions under which a person may become a shareholder or lose his position as a shareholder in such a company and, in my opinion, this case is completely covered by the reasons of this Court in *Reference re Constitutional Validity of s. 110 of the Dominion Companies Act*, [1934] S.C.R. 653.

The *Reference* case referred to by Judson J. concerned the constitutional competence of Parliament to enact legislation imposing personal liability on directors where payment of a dividend rendered the company insolvent or impaired its capital. Duff C.J.C., speaking on behalf of the court in that case, recognized the right of the federal Parliament to provide, inter alia, for the constitution of companies it created and for the conditions under which membership could be acquired. See also *Rathie* v. *Montreal Trust Co.*, [1953] 2 S.C.R. 204.

In view of the close analogy that may be drawn between the nature of the provisions considered by the court in the *Esso* case, *supra,* and the follow-up offer obligation here under consideration, it is our view that the approach taken by Judson J. in the *Esso* case would be applicable and that an amendment creating a follow-up offer obligation would be found to be intra vires the Parliament of Canada. A further issue concerns the effect that the enactment of such an amendment would have on the operation of similar provisions now contained in relevant provincial statutes, for example, the Securities Act (Ontario). Assuming that the provincial legislation now in effect were held to be intra vires the province experience under the Ontario legislation and the comments received on these *Proposals*''.[14]

It is an appropriate time to consider the Ontario experience, because the follow-up offer obligation has been controversial[15] and is being reconsidered by the Ontario Securities Commission[16] and the securities industry.[17] The purpose of this paper is to examine the Ontario experience with the follow-up offer obligation, analyze the administrative and judicial decisions interpreting its provisions, and offer some suggestions for reform.

In order to provide a framework within which the follow-up offer obligation can be adequately considered, this paper commences in Part II with a discussion of the theoretical debate concerning the sale-of-control problem, and then describes, in Part III, the historical background to the legislative implementation of the follow-up offer in Ontario. After setting out the framework of the

---

as a matter of property and civil rights, would these provisions be suspended and rendered inoperative in respect of corporations incorporated under the laws of Canada? A similar issue was recently considered by the Supreme Court of Canada in the *Multiple Access* case, *supra*. The majority of the court in that case held that the mere duplication of enactments at the federal and provincial levels without actual conflict or contradiction between them would not be sufficient to render otherwise valid provincial legislation inoperative. Dickson J. stated, at p. 209, that: ''In principle, there would seem to be no reason to speak of paramountcy and preclusion except if there is actual conflict in operation as where one enactment says 'yes' and the other says 'no'; 'the same citizens are being told to do inconsistent things'; compliance with one is defiance of the other. The courts are well able to prevent double recovery in the theoretical and unlikely event of plaintiffs trying to obtain relief under both sets of provisions.'' Accordingly, should a follow-up offer obligation in the CBCA merely duplicate existing provincial legislation, the provincial legislation would remain operative, duplication now being considered to be ''the ultimate in harmony'' (at p. 208). Should compliance with one set of provisions result in breach of the other, however, the otherwise valid provincial legislation would be rendered inoperative.

14. Anisman, Philip, Grover, Warren M.H., Howard, John L., and Williamson, J. Peter, *2 Proposals for a Securities Market Law for Canada* (Ottawa: Ministry of Supply and Services, 1979), p. 124.

15. See, for example, *The Globe and Mail*, Dec. 21, 1982 at p. B11, col. 4 and Dec. 30, 1982 at p.6, col. 1.

16. *Interim Report of the Committee to Review the Provisions of the Act Regulating Take-Over Bids* (1981), 2 O.S.C.B. 213A (hereinafter referred to as the ''Interim Take-Over Bid Review Report'' of the ''Review Committee''). The Ontario Securities Commission is herein referred to as the ''OSC'' or the ''commission''.

17. *The Regulation of Take-over Bids in Canada, Recommendations for a Uniform Canadian Framework (Progress Report)*, (Joint Industry Committee, Pierre Lortie, Chairman, March 30, 1983).

act with respect to the follow-up offer in Part IV, we analyze the administrative and judicial interpretation of the act in Part V. We offer some suggestions for reform in Part VI.

II. *The Theoretical Debate*

Some commentators argue that corporate shares are a form of personal property which should be freely transferable at whatever price the seller can obtain, even if the consideration involves a premium paid for the sale of a controlling block of shares.[18] On the other hand, others have argued that a premium paid for the purchase of corporate control should be shared equally amongst all shareholders of a corporation.[19] The views of the latter group of commentators can be generally categorized under the corporate asset or the fiduciary duty theories, or the equal opportunity rule.

(a) *The Corporate Asset Theory*

In 1932, Berle and Means formulated the corporate asset theory of corporate control, arguing that: ". . .the power going with "control" is an asset which belongs only to the corporation; . . .payment for that power, if it goes anywhere, must go into the corporate treasury . . . . "control" is a valuable piece of property to its holder, and so regarded; its value arises out of the ability which the holder has to dominate property which in equity belongs to others."[20] Berle later elaborated on the theory, saying that:

> The position of a majority shareholder, with his capacity to control, is . . . not a "property right" in the same sense as is his right to participate in dividends, or in liquidation or the like. His control power is really adventitious, a by-product of the corporate capacity to choose a board of directors by less than unanimity. This is why the control power — capacity to choose a management — is a corporate asset, not an individual one.[21]

---

18. See, for example, Posner, *infra,* note 33.
19. See generally, O'Neal, F. Hodge, *"Squeeze-outs" of Minority Shareholders* (Chicago: Callaghan & Company, 1975) c. 4, s. 405 at p. 198; O'Neal, *Sale of a Controlling Corporate Interest: Bases of Possible Seller Liability* (1976), 38 U. Pitt. L. Rev. 9.
20. Berle, A.A., and Means, G.C., *The Modern Corporation and Private Property* (Rev. ed. New York: Harcourt, Brace & World, 1968) pp. 216-217.
21. Berle, *The Price of Power: Sale of Corporate Control* (1965), 50 Cornell L.Q. 628 at p. 638.

Berle defines control as "the capacity to choose directors", and states that "[a]s a corollary, it carries capacity to influence the board of directors and possibly to dominate it",[22] so that "[t]he holder of control is not so much the owner of a proprietary right as the occupier of a power-position".[23] Berle's analysis of the corporate control position, in light of the then emergent American jurisprudence, led him to argue that premiums paid for corporate control should be shared equally:

> [Some] decisions dealing with the control function relate to benefits derived from its sale. These decisions point to a slowly emerging rule (by no means universally acknowledged) that, where stockholdings carrying controls [sic] are sold, any identifiable portion of the consideration paid for the power-position over and above the value of the stock ex the control-power element belongs not to the control-seller but to the corporation or (perhaps) to all the shareholders rateably.[24]

(b) *The Fiduciary Duty Theory*

The formulation of the sale-of-control problem, in terms of the corporate asset theory, also led Berle and Means to postulate a theory of the exercise of corporate powers in terms of trust.[25] Bayne, taking Berle and Means' work as his starting point in an analysis of the corporate control premium issue, argues that majority shareholders are subject to equitable controls, rendering them analogous to trustees: "The relation persisting between the office of corporate control and the corporation and its shareholders is in all essentials verified in the relationship between the office of trustee and the beneficiaries. With only accidental qualifications, therefore, corporate control is a strict trustee."[26] Under this

22. Berle, *"Control" in Corporate Law* (1958), 58 Colum. L. Rev. 1212 at p. 1212. See also Note, *The Sale of Corporate Control: The Berle Theory and the Law* (1963), 25 U. Pitt. L. Rev. 59.
23. Berle, *supra*, note 22 at p. 1215.
24. *Ibid*, at p. 1220.
25. *Supra*, note 20 at p. 219.
26. Bayne, *Corporate Control as a Strict Trustee* (1965), 53 Geo. L.J. 543 at pp. 549-550. See also Bayne, *A Philosophy of Corporate Control* (1963), 112 U. Pa. L. Rev. 22; Bayne, *The Sale-of-Control Premium: The Intrinsic Illegitimacy* (1969), 47 Tex. L. Rev. 215; Bayne, *The Sale-of-Control Quandry* (1965), 51 Cornell L.Q. 49; Bayne, *The Definition of Corporate Control* (1965), 9 St. Louis U.L.J. 445; Bayne, *The Sale of Corporate Control* (1965), 33 Fordham L. Rev. 583; Bayne, *The Sale-Of-Control Premium: the Definition* (1969), 53 Minn. L. Rev. 485; Bayne, *The Sale-Of-Control Premium: the Disposition* (1969), 57 Calif. L. Rev. 615; Bayne, *A Legitimate Transfer of Control: The Weyenberg*

analysis, by virtue of the majority shareholders' ability to dominate the affairs of the corporation through the election of directors and their consequent direction over management and assets of the corporation which belong to all shareholders, the majority shareholder is placed in a custodial relationship vis-à-vis the minority, and has a fiduciary duty of loyalty to ensure that the minority is treated equally when corporate control is sold.[27]

Brudney states that the issue is whether there is a duty of loyalty in addition to a mere duty of care, since a duty of care would only make a seller of control accountable where he failed to exercise appropriate care in selling to a purchaser whom he knew or should have known would be likely to unlawfully exploit the acquired position of control.[28] Brudney is in favour of the fiduciary duty of loyalty in a control situation, which, he argues, should not be diluted for other corporate considerations:

> [The consequences of a transfer of control], even without regard to the problem of private exploitation, are not likely to be beneficial to the other investors in the enterprise unless the purchasing group offers executive and managerial qualities which are superior to those offered by the selling group. But the selling group is under no duty to find or even to seek such a buyer. Hence, even apart from whether the premium should be shared on the theory that the "asset" for which it is being paid is an asset belonging to the corporation or to all stockholders rather than just to the sellers, it is difficult to see why rigorous fiduciary standards should be diluted when such a dilution may expose public investors to the risks connected with sales at a premium.[29]

Shoe-Florsheim Case Study (1966), 18 Stan. L. Rev. 438; Bayne, *The Noninvestment Value of Control Stock* (1970), 45 Ind. L.J. 317.

27. Bayne, *Corporate Control as a Strict Trustee, supra,* note 26 at p. 565. See also Jennings, *Trading in Corporate Control* (1956), 44 Calif. L. Rev. 1, who states, at p. 31, that: "[Where the majority shareholder sells his shares at a premium above investment value, he]. . .exploits corporate powers — powers which he holds in trust for the corporation and the other shareholders". But cf Note, *Fiduciary Duties of Majority or Controlling Stockholders* (1959), 44 Iowa L. Rev. 734, arguing that the majority or controlling shareholder should only have a fiduciary duty to inquire as to the possible effect the sale will have on the corporation and the remaining shareholders and that the duty should go further.

28. Brudney, *Fiduciary Ideology in Transactions Affecting Corporate Control* (1966), 65 Mich. L. Rev. 259 at pp. 296-297.

29. *Ibid,* pp. 298-299.

(c) *The Equal Opportunity Rule*

Andrews rejected the corporate asset theory due to its "operative difficulties",[30] and instead proposed a prophylactic rule of equal opportunity, as follows:

> [W]henever a controlling stockholder sells his shares, every other holder of shares (of the same class) is entitled to have an equal opportunity to sell his shares, or a prorata part of them, on substantially the same terms. Or in terms of the corollative duty: before a controlling stockholder may sell his shares to an outsider he must assure his fellow stockholders an equal opportunity to sell their shares, or as high a proportion of theirs as he ultimately sells of his own.[31]

Andrews argues first that his proposed rule will prevent sales of control that might cause a loss to the corporation, and second, that all shareholders should have an equal opportunity to share in the profits arising by virtue of the sale of shares.[32]

(d) *Arguments Against Sharing Control Premiums*

On the other hand, some commentators argue that there has been a misguided emphasis on corporate democracy by those arguing in favour of equal sharing of control premiums. These commentators believe that economic efficiency will be facilitated if there are no impediments to corporate control transactions. Posner states that:

> There would be another obstacle if proposals were adopted that would forbid a controlling shareholder, in selling his shares, to charge a premium for the control of the corporation that the sale bestows on the buyer. The underlying theory is that the

30. Andrews, *The Stockholder's Right to Equal Opportunity in the Sale of Shares* (1965), 78 Harv. L. Rev. 505 at p. 513. For example, if the premium for control were paid to the corporation, the purchaser of control would have the benefit of the premium as the new corporate controller. Thus, notwithstanding that the suit in *Perlman* was made on behalf of the corporation as a derivative action, the premium was directed to be paid to the minority to preclude the purchaser of control from benefitting by having the premium paid into the corporate treasury. See *Perlman, supra,* note 4 at p. 178.

31. Andrews, *supra,* note 30 at pp. 515-516.

32. For the first argument, see *Andrews, supra,* note 30 at pp. 517-21; for the second argument, see, *ibid,* at pp. 521-22. Jennings concurs and argues that "a sale of control shares should be accompanied by a general offer". See Jennings, *Trading in Corporate Control* (1965), 44 Calif. L. Rev. 1 at p. 39. See also, Leech, *Transactions in Corporate Control* (1956), 104 U.Pa. L. Rev. 725; stating, at p. 837, that a "broad rule of accountability in all control sale cases. . .has merit".

> controlling shareholder has fiduciary obligations to the minority shareholders. The theory has merit in the special cases. . .where there is a conflict of interest between majority and minority shareholders. But in the usual take-over situation the latter will be more injured than benefited by a rule that, by reducing the controlling shareholder's incentive to sell his control, retards the reallocation of the assets of the corporation to people who can use them more productively to the benefit of all of the shareholders.[33]

Easterbrook and Fischel share Posner's assumption that all sales of control are beneficial to the remaining shareholders, and argue that a majority shareholder should be able to sell his shares at a substantial premium without any obligation to share that premium with other shareholders. "The premium price received by the seller of the control bloc amounts to an unequal distribution of the gains. . . . this unequal distribution reduces the costs to purchasers of control, thereby increasing the number of beneficial control transfers and increasing the incentive for inefficient controllers to relinquish their positions."[34] Easterbrook and Fischel specifically reject the corporate asset theory and the equal opportunity rule advocated by Andrews and Jennings, as follows: "Both of these proposed treatments of the control premium would stifle transfers of control . . . . Minority shareholders would suffer under either rule, as the likelihood of improvements in the quality of management

33. Posner, Richard A., *Economic Analysis of Law* (2d. ed. Boston and Toronto: Little, Brown and Company, 1977) p. 304.

34. Easterbrook and Fischel, *Corporate Control Transactions* (1982), 91 Yale L.J. 698 at p. 716. See also, Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers* (1978), 57 Tex. L. Rev. 1; Easterbrook and Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer* (1981), 94 Harv. L. Rev. 1161 (arguing that resistance by a corporation's managers to premium tender offers ultimately decreases shareholder welfare); Easterbrook and Fischel, *Takeover Bids, Defensive Tactics, and Shareholders' Welfare* (1981), 36 Bus. Law. 1733. Other commentators have argued that rules of equal opportunity would be harmful, as they would inhibit beneficial transactions. See, for example, Javaras, *Equal Opportunity in the Sale of Controlling Shares: A Reply to Professor Andrews* (1965), 32 U. Chi. L. Rev. 420, stating, at p. 425, that ". . .the gravest defect in Professor Andrew's theory is a grievous underassessment of the costs of a preventative rule in restraining beneficial transactions"; Comment, *Sales of Corporate Control and the Theory of Overkill* (1965), 31 U. Chi. L. Rev. 725, stating, at p. 751, that: "The reluctance of the judiciary to impose a general rule of liability on sellers of controlling shares is basically sound. There is a strong possibility that a significantly large number of economically beneficial sales of control would be blocked by a rule that the seller is liable in all cases."

declined.''[35] They propose only one qualification: the controller should be allowed to keep his gain, subject only to the ''constraint that the other parties to the transaction be at least as well off as before the transaction.''[36]

Hill is likewise against a blanket rule of equal opportunity and suggests that ''progress in this difficult area is more likely to be achieved if the attention of the courts is focused on demonstrable evils and on solutions aimed specifically at such evils''.[37] Hill argues that the courts should only become involved where there is a clear detriment to the minority shareholders by the sale of control, such as where control is sold to persons whom the seller has reason to believe will loot or otherwise harm the corporation, and that to insist that a uniform offer be made to all shareholders when control is sold ''might well result in economic dislocations, with adverse effects outweighing any possible benefits, even from the point of view of the noncontrolling shareholders sought to be protected.''[38]

The analysis by commentators arguing that there should be no requirement for an equal opportunity for minority shareholders to sell shares where control is sold is predicated on the assumption that sales of control will ultimately benefit all shareholders in particular, and the economy in general, by, among other things, facilitating the infusion of better management into moribund corporations. A requirement for a pro rata offer to all shareholders would, they argue, likely preclude some beneficial transactions from taking place. As Easterbrook and Fischel put it:

> The sale of a control block of stock, for example, allows the buyer to install his own management team, producing the same gains available from a tender offer for a majority of shares but at a lower cost to the buyer. Because such a buyer believes he can manage the assets of a firm more profitably, he is willing to pay a premium over the market price to acquire control. The premium will be some percentage of the anticipated increase in value once

35. *Corporate Control Transactions, supra,* note 34 at p. 716.

36. *Ibid,* at p. 698. See also Katz, *The Sale of Corporate Control* (1976), 38 Chi. B. Rec. 376; Comment, *Sale of Corporate Control* (1952), 19 U. Chi. L. Rev. 869.

37. Hill, *The Sale of Controlling Shares* (1957), 70 Harv. L. Rev. 986 at p. 988.

38. *Ibid,* at p. 1039. See also Comment, *Sales of Corporate Control at a Premium: an Analysis and Suggested Approach,* [1961] Duke L.J. 554 (utilizing fiduciary concept in cases of fraud and negligence, but any further imposition of liability on seller of corporate control is unwarranted and unsound).

> the transfer of control is effectuated . . . . There is a strong presumption, therefore, that free transferability of corporate control, like any other type of voluntary exchange, moves assets to higher valued uses.[39]

Some commentators argue that this assumption ignores the fact that many take-overs occur not because the target corporation is badly operated, but because it is an efficient and well-run corporation which may be undervalued due to prevailing economic conditions, and not due to poor management.[40] We would also add, based upon our own experience, that it is hard to justify some take-overs on economic grounds. Some take-overs have been the civilized equivalent of war in the private sector and gamesmanship and power has been the motivating factor. Furthermore, as Leech argues, economic evidence has not been provided to show that a requirement of a sharing of the control premium will unduly impede the take-over bid technique:

> That the economics of control sales has traditionally resulted in a private benefit accruing to holders of control does not prove that the results should be encouraged. A balance of the interests of all shareholders is involved; only when that balance has been established may it be stated what the controlling shareholder's property rights are and what they are not. It may be further objected that a requirement of accounting for premium prices received from a sale of control may serve to stagnate corporate ownership, that there are greater risks from restraining sales of controlling shares than from permitting new blood to enter the corporation by purchase of control. Insistence on an even-handed offer to all shareholders may block some control transfers; it will not block all of them. Further, it is still to be shown that there is inherent virtue in protecting a system whereby one block of shareholders largely unresponsive to their fellows is supplanted by another.[41]

39. *Corporate Control Transactions*, *supra*, note 34 at p. 705.

40. See, for example, Block and Schwarzfeld, *supra*, note 3 at p. 135.

41. Leech, *supra*, note 32 at p. 838. See also Andrews, *supra*, note 30 — he states, at p. 519, that ". . .I do not believe the rule of equal opportunity would have much tendency to discourage beneficial transactions. After all, if the purchaser is optimistic — and can convince his bankers to share his optimism — he should be willing to buy out everyone"; Brudney, *supra*, note 28, states, at p. 299, that: "Certainly before diluting [fiduciary standards] as substantially as has been suggested, some imperative need for allowing a controlling stockholder to sell at a premium should be shown, or some empirical evidence should be offered to establish that controlling groups are likely to sell out more readily to economically desirable purchasers if they are permitted to receive a premium, or that there is

(e) *A Synthesis: Fiduciary Duty and Equal Opportunity*

An analysis of the theoretical bases giving rise to a fiduciary obligation demonstrates that the fiduciary concept could be applicable where the majority shareholder sells control without an equal opportunity being extended to the minority shareholders to sell their shares. The theory of unjustifiable enrichment holds that a fiduciary relationship exists where one person obtains property or other advantage which justice requires should belong to another person.[42] The unequal relationship theory focuses on the inequality of footing of the parties, providing generally that a fiduciary obligation arises where the stronger party takes action which affects the property rights of the weaker party.[43] Majority and minority shareholders are on unequal footing because the majority shareholders are in a position to sell control which affects the property rights of the minority. Control can be viewed as a corporate asset which, like other corporate assets, should be shared equally when it is sold.[44] When the majority shareholder sells control without sharing the premium with, or ensuring that an equal offer be made to, the minority, then the minority is left in an unequal position: the minority shareholder can stay with new management he has not chosen, or he can sell his shares at a price which will likely be substantially lower than that obtained by the majority seller.[45] In these circumstances, social goals of fairness and justice might arguably require that equality be ensured. Furthermore, the fiduciary concept accords with the commercial utility theory,[46] which holds that the fiduciary obligation performs the "function of maintaining the integrity of the marketplace."[47]

---

some over-all social or economic need so to encourage transfers of control of publicly held corporations. No such evidence has been offered, nor has such a need been demonstrated."

42. Shepherd, *Towards a Unified Concept of Fiduciary Relationships* (1981), 97 L.Q. Rev. 51 at p. 53. *See also* Jones, *Unjust Enrichment and the Fiduciary's Duty of Loyalty* (1968), 84 L.Q. Rev. 472; Shepherd, *The Law of Fiduciaries* (Toronto: The Carswell Company Limited, 1981) p. 71.

43. Shepherd, *supra*, note 42 at p. 61.

44. See, *supra*, text accompanying note 20.

45. See, *infra*, note 72.

46. Shepherd, *supra*, note 42 at p. 56. See also Weinrib, *The Fiduciary Obligation* (1975), 25 U. Toronto L.J. 1.

47. Weinrib, *supra*, note 46 at p.15. See also Cary, *Federalism and Corporate Law: Reflections Upon Delaware* (1974), 83 Yale L. J. 663, who states, at p.671, that ". . .business should be conducted fairly, honestly, and competently. Indeed, these ingredients are essential to raise capital and make the system work.";

Trust law describes the fiduciary concept in terms of the duty of loyalty,[48] and in cases of unjustifiable enrichment, provides the remedy of the constructive trust to ensure the sharing of property which has been obtained by one party, but which in equity belongs to, or should be shared with, others.[49] Corporate law has increasingly protected shareholders from transactions abusive to the corporation, and, ultimately, to the shareholders, through the employment of the fiduciary concept, as in the corporate opportunity cases.[50] Securities law interacts with corporate law, as its essential purpose is to protect shareholders and ensure fairness in order to promote economic efficiency by the maintenance of confidence in the capital markets.

An analysis of corporate control transactions in terms of a "synthetic approach"[51] at the interface of unjustifiable enrichment and corporate, securities, and trust law leads us to conclude that, based upon this approach, majority shareholders should have a fiduciary duty to ensure that other shareholders share in a premium obtained on the sale of control. The seller of control is unjustifiably enriched at the expense of the minority shareholder if a control premium is not shared. Fairness and justice demand that there should be some legal mechanism to assure that a control premium is shared with other shareholders by the seller of control. One might be justified in departing from concepts of fairness and justice if it were necessary to assure that take-over bids were not unduly impeded, since take-over bids may assist in achieving economic efficiency in the private sector. What evidence there has been to

---

Submission of the Toronto Stock Exchange to the Ontario Securities Commission, Follow-up offers Regarding Premium Transactions, TSE Notice to Members No. 1856, April 11, 1979, which states, at pp. 5-6, that: "In the simplest terms, the long-term effectiveness of Canada's capital markets. . .in raising capital to meet industry's requirements depends upon investor confidence. This, in turn, assumes a public market in which all shareholders are offered an equal opportunity to participate rateably in any sale of shares pursuant to a favourable offer for the purchase of controlling shares in their corporation."

48. See Waters, D.W.M., *Law of Trusts in Canada* (Toronto: The Carswell Company Limited, 1974) p.33.

49. See Baker, P.V. & Langan P.St.J., *Snell's Principles of Equity* (28th. ed.), London: Sweet & Maxwell Ltd. 1982, pp. 192-193.

50. See e.g., *Canadian Aero Services Ltd.* v. *O'Malley,* [1974] S.C.R. 592; *Cook* v. *Deeks,* [1916] 1 A.C. 554 (P.C.).

51. Samek, *The Synthetic Approach and Unjustifiable Enrichment* (1977), 27 U. Toronto L. J. 335 at p. 337. See also Fridman, *Restitution Revindicated, or The Wonderful World of Professor Samek* (1979), 29 U. Toronto L.J. 160.

date does not, however, indicate that take-over bids in Ontario or Canada have been unduly impeded by the follow-up offer obligation. We believe that legislators should implement an equal opportunity law, as has been the case in Ontario, since one cannot, and perhaps should not, rely on the judicial system to develop either the corporate asset theory or the fiduciary duty theory to protect minority shareholders.

III. *Historical Background to the Follow-Up Offer Obligation*

The advent of modern securities legislation in Canada can be ascribed to the enactment of The Securities Act, 1966 (Ontario),[52] which implemented the recommendations of the *Report of the Attorney General's Committee on Securities Legislation in Ontario.*[53] Concern about the legality and ethics of several take-over bids led to the adoption, in 1963, of a voluntary code of take-over bid procedure by a group of associations.[54] Since the

---

52. S.O. 1966, c. 142. See generally, Bray, "Recent Developments in Securities Administration in Ontario: The Securities Act, 1966", in J. Ziegel, ed., *Studies in Canadian Company Law* 415, (Toronto: Butterworths, 1967) at pp. 417-419 and pp. 437-439.

53. March 11, 1965 (hereinafter the "Kimber Report"). Mr. Kimber was appointed chairman of the commission in 1963 and, upon his appointment, he recommended to the then Attorney General that a committee (namely, the Kimber Committee) be appointed to study the securities laws. The suggestion was accepted, and the Kimber Committee was established in October 1963. See J.C. Baillie, *The Protection of the Investor in Ontario* (1965), 8 Can. Pub. Admin. 172, 325 at p. 207. The Kimber Committee had the following terms of reference, as set out in the Kimber Report at p. 6, para. 1.01: "To review and report upon, in the light of modern business conditions and practices, the provisions and working of securities legislation in Ontario and in particular to consider the problems of take-over bids and of 'insider' trading, the degrees of disclosure of information to shareholders, the requirements as to proxy solicitation, procedures as to primary distribution of securities to the public and like matters, and generally to recommend what, if any, changes in the law are desirable."

Prior to the implementation of the Kimber Report recommendations, securities legislation in Ontario was directed primarily to disclosure of relevant facts to potential purchasers of securities in primary distributions and to control of market actors through licensing requirements; control of market practices was basically left to enforcement through the *Criminal Code* or to the common law. See Creber, "Take-over Bids, Insider Trading and Proxy Requirements", in *Developments in Company Law — Special Lectures of the Law Society of Upper Canada* 235 (Toronto: Richard De Boo Limited, 1968) at p. 235; Kimber Report, p. 9, para. 1.16.

54. "A Recommended Code of Procedure to be applied in connection with Take-over Bids" (1963), prepared after consultation among members of the

voluntary code was not followed in many take-over bids, the Kimber Report recommended that it be supplanted by legislative measures.[55] These measures were ". . .designed to protect the general public by averting potential abuses while impeding as little as possible the use of the take-over bid technique",[56] and focused on adequate and timely disclosure of information to offeree shareholders, in order ". . .to permit them to come to a reasoned decision as to the desirability of accepting a bid for their shares."[57] The Kimber Committee did not adopt a definition of a take-over bid in terms of the acquisition of legal control, as that would have left free from regulation those offers where the objective was the acquisition of effective, but not necessarily legal, control. The recommended definition was thus an offer (other than by private agreement or by purchase on a stock exchange or in an over-the-counter market) made to the holders of voting shares of a public company, which would, if accepted, give the bidder more than twenty percent of the outstanding voting shares.[58] Since the Kimber Report recommended that private agreements be an exception from the take-over bid requirements, the crucial question of the right of minority shareholders to share in a control premium paid to majority shareholders was left open, as follows:

> It follows from the suggested definition of a take-over bid that the Committee's recommendations for a statutory code will not relate to the acquisition or intended acquisition, by way of private agreement, of blocks of shares which represent legal or effective control. The Committee recognizes that, as a result, its recommendations will not embrace situations where control of a public company changes hands under circumstances in which the general body of shareholders is not afforded the same opportunity to dispose of their shares (at a possible premium over market) as is enjoyed by a control group. We are of the opinion that the evolution of a legal doctrine which may impose upon directors or other insiders of a company who constitute a control group a

---

Executive Committees of the Trust Companies Association of Canada, the Investment Dealers' Association of Canada, The Toronto Stock Exchange (hereinafter the "TSE"), the Montreal Stock Exchange, the Vancouver Stock Exchange, and the Canadian Stock Exchange. See the Kimber Report, *supra,* note 53 at p. 21, para. 3.06. See also Creber, *supra,* note 53 at p.245; Baillie, *supra,* note 53 at p. 207.

55. Kimber Report, *supra,* note 53 at p. 21, para. 3.06.
56. *Ibid,* at p. 22, para. 3.07.
57. *Ibid,* at p. 22, para. 3.10.
58. *Ibid,* at p. 23, para. 3.11.

> fiduciary duty toward other shareholders of such company in cases of control is, apart from insider trading aspects, a matter to be left to development by the judicial process.[59]

One can say, with the benefit of hindsight, that this decision by the Kimber Committee was perhaps unfortunate, given the lack of subsequent judicial development providing minority shareholders with an opportunity to share in a premium paid for control. The Kimber Committee was obviously concerned about the equal treatment of all shareholders, because it recommended pro rata acceptance where shares deposited under a bid exceeded the number specified in the offer,[60] and provided that where an offeror increases the price of his offer, the higher price should be paid for shares accepted on the initial, as well as the amended, offer.[61] The recommendation of the Kimber Report to exempt private agreements was implemented in The Securities Act, 1966, where an "exempt offer" was defined to include "an offer to purchase shares by way of private agreement with individual shareholders and not made to shareholders generally".[62] No limit was placed on the number of private agreements that could be effected, thus permitting a possible interpretation that any number of individual shareholders could be approached with an offer while still coming within the terms of the exemption.[63] The Securities Amendment Act, 1971 narrowed the "exempt offer" definition by replacing it with the definition of "an offer to purchase shares by private agreement *with fewer than 15 shareholders* and not made to shareholders generally."[64]

---

59. *Ibid,* at p. 23, para. 3.12. Baillie, *supra,* note 53, states, at p. 259, that: "The Committee very wisely avoids the difficult problem of whether and to what extent a small group holding the majority of the shares should be liable to the minority shareholders when the members of the group sell their shares at a price in excess of that available to the minority". He did not give reasons for his belief that the Kimber Committee had made a correct judgment.
60. Kimber Report, *supra,* note 53 at p. 24, para. 3.15 and p. 25, para. 3.17.
61. *Ibid,* at p. 26, para. 3.22.
62. S.O. 1966, c.142, clause 80(b)(i); "take-over bid" was defined in clause 80(g).
63. See Creber, *supra,* note 53 at p. 246.
64. S.O. 1971 vol. 2, c. 31, section 22 (emphasis added). Section 22 of the 1971 Act was added following the recommendation in the *Report of the Committee of the Ontario Securities Commission on the Problems of Disclosure Raised for Investors by Business Combinations and Private Placements February, 1980* (herein called the "Merger Study"), which stated, at p.92, para. 7.10, that: "At some point the number of private agreements suggest a general offer. We suggest they be restricted to fifteen".

In 1970, the OSC reconsidered, in its Merger Study, the question of fairness to minority shareholders in take-over bid legislation, and rejected the view that exempt offers should be prohibited, requiring all acquisitions to be made pro rata to all shareholders. "Such a conclusion would reduce incentive to a common denominator, including the incentive to control, manage, build, and then divest to take the benefit of those efforts. The solution providing equality is simple. The result of such a solution would be profound."[65] The study referred specifically to the private agreement exemption, and reached the same conclusion as the Kimber Report, namely, that the control premium question should be left to judicial development as a matter of corporate law:

> The exemption raises the question as to whether some special liability or responsibility should result when the purchaser through a private agreement pays a premium over the market price. In this connection we have considered the approach taken through the so-called "City Code" in the United Kingdom developed by the City of London Investment Committee to govern take-overs.[66] Under it the directors who effectively control as well as controlling shareholders represented on the board should not sell that control without obtaining the buyer's undertaking to extend a comparable offer to the remaining shareholders. This condition has in fact been required in a number of cases by Canadian controlling shareholders. The U.K. rule may be waived "in very exceptional circumstances" as to which the City Panel must be consulted in advance.
>
> This rule in the City Code has a most appealing appearance of fairness. On the other hand . . . it does move further down the road towards removing all incentive for entrepreneurship. The control person is subjected to insider liability. The draft Business Corporations Act (Bill 125) forecasts more stringent restrictions on the conduct of management. The concept of oppression of the minority has been rejected by the Select Committee in favour of statutory standards.[67] . . .we have not yet concluded that control

65. *Supra,* note 64 at p. 89, para. 7.04.
66. *The City Code on Take-over and Mergers* (Rev'd ed. February, 1981, as amended June, 1982). See generally, Blank, M.V., and Greystoke, A.L., *Weinberg and Blank on Take-Overs and Mergers* (4th ed. London: Sweet & Maxwell, 1979) c.12, para. 1201; Gower, L.C.B. *Review of Investor Protection* (London: Her Majesty's Stationery Office, January 1982) pp. 36-37, paras. 3.27-3.28.
67. The oppression remedy is now provided for in the Business Corporations Act, 1982, S.O. 1982, c.4, s.247 (hereinafter the "OBCA"). Compare CBCA, s.234. See generally, Beck, "Minority Shareholders' Rights in the 1980s", in *Corporate*

> persons have so abused their positions as to require special treatment as a matter of securities legislation. Accordingly, we find no reason to recommend deviating from the conclusions reached in paragraph 3.12 of the Kimber Report that as to questions of fairness of treatment as between shareholders this is a matter for corporation law and the courts. Securities legislation may then follow the lead given.[68]

It is regrettable that the Merger Study recommended that the question of fairness of treatment between shareholders was a matter of corporate law, as it has been noted that "the distinction between corporate and securities law is a largely artificial one that was developed in the United States to meet distinctive constitutional problems in that country."[69] Indeed, the question of fairness of treatment as between shareholders is a matter that should be addressed by securities regulators in order to ensure fairness in the capital markets. A corporation that wishes to have public shareholders should not be permitted to accept the benefits of going public, such as easier access to capital, without also accepting the responsibility to ensure fair treatment for the public shareholders.

In 1973, the *Report on Mergers, Amalgamations and Certain Related Matters by Select Committee on Company Law*[70] was released. It stated the control premium problem in the following terms:

> The acquisition of effective control by private agreement almost invariably involves the payment of a premium to the selling shareholders and in many cases no general offer is made to the other shareholders to acquire their shares on the same or substantially similar terms. The other shareholders are in the position where control of the corporation in which they have invested has changed leaving them with two options — to remain as shareholders and accept the changed situation or to sell their shares on the market at a price which will undoubtedly be less than the price received by the controlling shareholders . . . should the legislation remove the present private agreement

---

Law in the 80s, Special Lectures of the Law Society of Upper Canada 311 (Don Mills: Richard De Boo Publishers, 1982) at pp. 312-320.

68. Merger Study, *supra*, note 64 at pp. 91-92, paras. 7.08-7.09 (without footnotes).

69. Baillie, "Shareholders' Remedies", in *New Developments in the Law of Remedies, Special Lectures of the Law Society of Upper Canada* 21 (Don Mills: Richard De Boo Limited, 1981) at p. 29.

70. Tabled in the Legislative Assembly by William Hodgson, M.P.P. Chairman, 3rd Session, 29th Legislature (herein called the "Hodgson Report").

> exemption or should the legislation continue the exemption but require, as a condition, that a general offer be made by the offeror to all other shareholders of the same class?[71]

Representatives of the OSC testified before the Select Committee that they had changed their position since the publication of the Merger Study and that they favoured the requirement of a general offer to the remaining shareholders.[72] The Select Committee was, however, divided on the issue, with the majority favouring the maintenance of the private agreement exemption[73] and the minority arguing that the exemption should be made conditional upon the person acquiring control making an equivalent offer, within sixty days of the acquisition of control, to the remaining shareholders of the same class.[74] This offer could not be conditional on any level of acceptance, but the OSC would have had discretion to provide an exemption from the requirement where there was a compelling reason to do so[75] and the form of consideration could be different.[76] The minority of the Select Committee stated their views as follows:

> While the elimination or reduction of the premium on the sale of control may be viewed as a move towards removing an incentive for entrepreneurship, the minority of the Committee feels that on analysis the argument in favour of permitting such a premium may not be as strong as it appears. Conceptually, at least, each share in the capital of a company is the same as every other share of the same class and entitles the holder to an aliquot interest in the company. When a controlling shareholder sells control, the thing he is really selling is corporate assets and the right to control the use of those assets and those assets belong to all of the shareholders, not merely the controller. There are . . . valid arguments to be made on a conceptual basis that any premium on the sale of control should be shared by all shareholders. The minority of the Committee rejects the argument that the

71. *Ibid*, at p. 28, para. 1.
72. *Ibid*, at para. 2.
73. *Ibid*, at pp. 30-31, para. 7. It was favoured primarily on the ground that corporate shares are a form of personal property which an owner should be entitled to freely sell and that an obligation of a general offer to shareholders would reduce entrepreneurial incentives for a person to develop a business by denying such a person a "well merited premium for his efforts".
74. *Ibid*, at p. 31, para. 8.
75. *Ibid*, at p. 33, para. 13. The OSC would have discretion to exempt, for example, where an acquisition of twenty percent of the voting shares would not constitute an acquisition of effective control. See, *ibid*, at p. 33, para. 12.
76. *Ibid*, at pp. 31-32, para. 10. For example, notwithstanding that cash was paid to the majority, the minority could be paid in securities.

> requirement for a general offer would lead to economic hardship as a justification for maintaining the present exemption. The minority is not entirely persuaded that economic hardship would be an inevitable result. The minority adopts the principles of the City Code on this important matter and agrees with the language of the introduction to the City Code that the requirement for a general offer must be regarded as "good standard commercial behaviour based upon a concept of equity between one shareholder and another". The argument that the City Code is not a legal enactment is, in the view of the minority, not convincing since the provisions of the City Code are invariably followed in almost every instance.[77]

With the groundwork for modern securities legislation having been laid in The Securities Act, 1966, as amended,[78] the Ontario government commenced the process of making substantial revisions to the securities legislation of the province in the 1970s, which ultimately led to the resolution of the problem of control premiums by the retention of the private agreement exemption, together with the adoption of the follow-up offer obligation in Bill 7, The Securities Act, 1978.[79] Apparently, no economic studies were

---

77. *Ibid*, at p. 31, para. 9.

78. The Securities Act, 1966, S.O. 1966, c.142, as am. by The Securities Amendment Act, 1967, S.O. 1967, c. 92, The Securities Amendment Act, 1968, S.O. 1968, c. 123, The Securities Amendment Act, 1969, S.O. 1968-69, c. 116, and The Securities Amendment Act, 1971, S.O. 1971 vol. 2., c. 31.

79. S.O. 1978, c. 47. Bill 7 received first reading February 28, 1978, third reading June 23, 1978, and was proclaimed in force September 15, 1979. See generally, Baillie, "Securities Regulation in the '70s", in J. Ziegel, ed., 2 *Studies in Canadian Company Law* 343 (Toronto: Butterworths, 1973) at p. 345.

Several bills were introduced in the Legislature prior to Bill 7. Bill 154, which was introduced in 1972 as The Securities Act, 1972 and received first reading on June 1, 1972, continued the private agreement exemption of The Securities Act, 1966, as did Bill 75, The Securities Act, 1974, which was introduced to replace Bill 154 and received first reading on June 7, 1974. In September 1974, the OSC published a set of draft regulations under Bill 75. Bill 98, The Securities Act, 1975, which received first reading on May 30, 1975, substantially implemented the recommendations of the minority of the Select Committee in the Hodgson Report by eliminating the private agreement exemption, so that an offeror making a take-over bid would have had to make the offer to all security holders whose last address, as shown on the books of the offeree company, was in Ontario. The obligation would have applied even to a purchaser of control not paying a control premium, that is, even a purchaser making an offer at or below the market value, which one commentator termed "an unnecessarily burdensome restriction". See Dey, *Securities Reform in Ontario: The Securities Act, 1975* (1975), 1 Can. Bus. L.J. 20, at p. 38. Dey expressed concern for the economic implications of the elimination of the private agreement exemption in Bill 98, stating, at p. 38, that:

undertaken to consider the implications of the maintenance of the private agreement exemption with a follow-up offer obligation.[80] Rather, the solution proposed by Bill 7 was a compromise between those advocating minority shareholder protection and those advocating the improvement of the integrity of the capital markets without placing undue restrictions on the entrepreneur when dealing in the public marketplace.[81] The follow-up offer obligation did, however, create considerable controversy, and the then minister resolved the matter by instructing the OSC chairman to arrange for public hearings, following which guidelines would be published of the circumstances in which the OSC would grant exemptions from the obligation to make a follow-up offer before the new act became law:

> After careful consideration, we have concluded that it is prejudicial to the credibility of the public marketplace to permit the owner of a corporation who has taken in minority shareholders to dispose of his shares subsequently at a premium that is unavailable to the minority. . . .

> Under Bill 98, the acquisition of a company by way of a share offer will be a very expensive proposition. Fewer companies will be able to muster the resources to undertake the payment of a premium for control and the extension of an offer upon similar terms to the balance of the target company shareholders. It will be only the large companies which will be able to make the acquisitions — probably resulting in increased concentration of industry. Bill 98 is a piece of legislation which should receive some consideration from the recently appointed Royal Commission studying the concentration of business in Canada.

Bill 20, The Securities Act, 1977, which received first reading on April 5, 1977, continued the withdrawal of the exemption for take-overs by private agreement so bids would have to be pro rata. See generally, Johnston, *Canadian Securities Regulation, supra,* note 8 at p. 341. Bill 20 was reintroduced as Bill 30, which received first reading on June 29, 1977 and continued the exclusion of the private agreement exemption. Bill 7 was then introduced in 1978.

80. Notwithstanding some concern that the economic implications of regulatory changes be considered. See, for example, Dey, *supra,* note 79 at p. 38; Baillie, *supra,* note 79 at p. 345.

81. See *New Securities Legislation* (Toronto: Department of Continuing Education, Law Society of Upper Canada, May 1978) per Baillie at p. 20, and Dey at pp. 22-23. Due to the technical nature of securities legislation, the drafting of the act was exclusively the work of the OSC. See Connelly, "Securities Regulation and Freedom of Information", *Commission on Freedom of Information and Individual Privacy, Research Publication 8,* (Ontario 1979) at p. 91; Baillie, *supra,* note 79 at p. 353, argues that the legislative process provides a more meaningful review in the United States. See also *Legislature of Ontario Standing Committee on the Administration of Justice on vote 1502, commercial standards program; item 1, securities* (1981), 2 O.S.C.B. 240A, per Mr. Renwick at pp. 241A-242A.

> However, we recognize that situations could arise in which the provisions of the Bill could impede or even prevent the consummation of a desirable transaction. For example, where a control block is held outside Canada, over-riding economic interests might dictate that the repatriation of that block should be permitted even if a premium must be paid. Also, sale of a comparatively small number of shares might sometimes tilt the balance of control; it is doubtful that such a transaction should trigger the obligation for a follow-up offer to the minority.[82]

In compliance with the request, the commission published draft guidelines in August 1978,[83] which were substantially revised and eventually adopted as OSC Policy 3-41 before the act came into force.[84]

IV. *The Framework of the Act*

(a) *The Act and Regulation*

Part XIX of the act provides for the regulation of take-over bids, which are defined in clause 88(1)(k), as follows:

> (i) an offer made to security holders, the last address of any of whom as shown on the books of the offeree company or other issuer[85] is in Ontario, to purchase directly or indirectly voting securities[86] of the company or other issuer,

---

82. The then Minister of Consumer & Commercial Relations, The Hon. Larry Grossman (June 15, 1978), in OSC *Weekly Summary,* 11 August 1978, Supplement "X", p. 4.

83. OSC *Weekly Summary,* 11 August 1978, Supplement "X". The draft guidelines stated that the OSC would consider any application for an exemption on its merits, taking into account all relevant circumstances, and set out, at p. 2, three specific situations which the OSC indicated would be appropriate cases for an exemption from the follow-up offer obligation:

1. Where a Canadian offeror pays a nonresident of Canada a premium for control of a Canadian corporation on the ground that the national economic policy would favour repatriation of control;
2. Where the controller is an owner-manager and wishes to retire and transfer his interest at a premium to employees of the corporation; and
3. Where the majority of the noncontrolling shareholders agree to waive their rights to the follow-up offer.

84. *Infra,* note 107.

85. Paragraph 1(1)4: " 'company' means any corporation, incorporated association, incorporated syndicate or other incorporated organization"; paragraph 1(1)18: " 'issuer' means a person or company who has outstanding issues, or proposes to issue, a security".

86. Paragraph 1(1)44: " 'voting security' means any security other than a debt security of an issuer carrying a voting right either under all circumstances or under some circumstances that have occurred and are continuing."

(ii) the acceptance by a person or company of an offer to sell voting securities of a company or other issuer and such acceptance shall be deemed to constitute an offer to purchase and the person or company accepting the offer shall be deemed to be an offeror,[87] or

(iii) a combination of an offer to purchase referred to in subclause (i) and an acceptance of an offer to sell referred to in subclause (ii),

where the voting securities which are the subject of the offer to purchase, the acceptance of the offer to sell or the combination thereof, as the case may be, together with the offeror's presently owned securities will in the aggregate exceed 20 percent of the outstanding voting securities of the company or other issuer and where two or more persons or companies make or accept offers jointly or in concert or intending to exercise jointly or in concert any voting rights attaching to the securities to be acquired, then the securities owned by each of them shall be included in the calculation of the percentage of the outstanding voting securities of the company or other issuer owned by each of them;[88]

The Securities Amendment Act, 1982 would clarify the second branch of the definition of a take-over bid, contained in sub-paragraph 88(1)(k)(ii), by specifying that the test of an Ontario address for the offeree security holder applies to an offer to sell, as well as an offer to purchase.[89] The proposed amendments would

87. Clause 88(1)(h): " 'offeror' means a person or company other than an agent, who makes a take-over bid or an issuer bid and where two or more persons or companies make offers, (i) jointly or in concert, or (ii) intending to exercise jointly or in concert any voting rights attaching to the security acquired through the offers, then each of them shall be deemed to be an offeror if the offer made by any of them is a take-over bid".

88. Securities Act, R.S.O. 1980, c. 466, clause 88(1)(k).

89. Bill 176, 2nd Sess., 32nd Legislature Ontario, 1982, 2nd Reading: November 2, 1982. Section 31 provides, inter alia, that:

(2) Subsection 88(1) of the said Act is amended by adding thereto the following clause:

(ea) "offer to purchase" is an offer to purchase, the acceptance by a person or company of an offer to sell or a combination of an offer to purchase and an acceptance of an offer to sell.

(4) Clause 88(1)(k) of the said Act is repealed and the following substituted therefor:

(k) "take-over bid" means an offer to purchase, directly or indirectly, voting securities of a company or other issuer made to security holders, the last address of any of whom as shown on the books of the offeree company or other issuer is in Ontario, where the voting securities which are the subject of the offer to purchase, together with the offeror's presently owned securities, will carry in the aggregate, 10 per cent or more of the voting rights attached to the voting securities of the company or other issuer that also change the threshhold level of a take-over bid from twenty percent of the currently outstanding voting securities to ten percent of the voting rights attaching to the voting securities that would be outstanding on a fully diluted basis. However, a follow-up offer would only be required where the twenty percent level is exceeded.[90]

The act provides for certain exemptions from the requirements of Part XIX, including, inter alia, the private agreement exemption, as follows:

> 88(2) Subject to subsection 91(1), a take-over bid is exempted from the requirements of this Part where,
>
> (c) it is an offer to purchase securities by way of agreements with fewer than fifteen security holders and not made pursuant to an offer to security holders generally, but where an offeror enters into an agreement to purchase securities from a person or company and the offeror knows or ought to know after a reasonable inquiry that,
>
> (i) one or more other persons or companies on whose behalf that person or company is acting as trustee, executor, administrator or other legal representatives, have a direct beneficial interest in those securities, then each of such others shall be included in the determination of the number of security holders with whom there

---

would be outstanding on the exercise of all currently exercisable rights of purchase, conversion or exchange relating to voting securities and where two or more persons or companies make offers to purchase jointly or in concert or intending to exercise jointly or in concert any voting rights attaching to the securities to be acquired, then the voting rights attaching to the securities owned by each of them shall be included in the calculation of the percentage that the voting rights attaching to the voting securities of the company or other issuer owned by each of them is of all voting rights that would be attached to all voting securities that would be outstanding on the exercise of all currently exercisable rights of purchase, conversion or exchange relating to voting securities traded.

(5) The said subsection 88(1) is further amended by adding thereto the following clause:

(m) "voting security" includes,

(i) a security currently convertible into a voting security or into another security that is convertible into a voting security,

(ii) a currently exercisable option or right to acquire a voting security or another security that is convertible into a voting security, or

(iii) a security carrying an option or right referred to in sub-clause (ii).

The change in the threshhold level from twenty percent to ten percent brings the act into conformity with the CBCA and the OBCA, but makes the level inconsistent with other provincial securities legislation.

90. Securities Amendment Act, 1982, *supra*, note 89, s.34.

have been agreements, but where an inter vivos trust has been established by a single settlor or where an estate has not vested in all persons beneficially entitled thereto, the trust or estate shall be considered to be a single security holder in such determination, or

(ii) the person or company acquired the securities during the two years preceding the date of the agreement with the intent that they should be sold under such agreement, then each person or company from whom those securities were acquired shall be included in the determination of the number of security holders with whom there have been agreements;

The follow-up offer obligation is provided for in subsection 91(1), as follows:

91(1) Where a take-over bid is effected without compliance with section 89[91] in reliance on the exemption in clause 88(2)(c), if there is a published market[92] in the class of securities acquired and the value of the consideration paid for any of the securities acquired exceeds the market price at the date of the relevant agreement plus reasonable brokerage fees or other commissions, the offeror shall within 180 days after the date of the first of the agreements comprising the take-over bid, offer to purchase all of the additional securities of the same class owned by the security holders, the last registered address of whom is in Ontario or in a uniform act province,[93] at and for a consideration per security at least equal in value to the greatest consideration paid under any

91. Section 89 contains conditions relating, inter alia, to disclosure, timing, and equal treatment of offeree shareholders.

92. Clause 88(1)(j): " 'published market', as to any class of securities, means a stock exchange recognized by the Commission for the purposes of this Part on which such securities are listed, or any other market on which such securities are traded if the prices at which they have been traded on that market are regularly published in a bona fide newspaper or business financial publication of general and regular paid circulation."

OSC Policy 3-43, paragraph 3, states that the commission recognizes only The Toronto Stock Exchange for the purpose of the definition. This does not, however, mean that the TSE is the only stock exchange which constitutes a "published market", because clause 88(1)(j) refers to "any other market on which such securities are traded if the prices at which they have been traded on that market are regularly published in a bona fide newspaper or business or financial publication of general and regular paid circulation."

93. Clause 88(1)(l): " 'uniform act province' means a province or territory of Canada designated in the regulations as a province or territory which has legislation in effect containing provisions substantially the same as this Part and section 129."

The act was intended to be a model for the other provinces in Canada. In introducing Bill 30, The Securities Act, 1977, to the Ontario Legislature on November 24, 1977, the then minister, The Hon. Larry Grossman, commented, in [1977] O.S.C.B. 272, that: "The securities bill is designed to provide a model for such agreements, and that offer shall be a take-over bid for the purposes of this Part.[94]

---

other provinces. We have received reasonable assurance that its adoption as a uniform provincial Act will afford all Canadians with the high level of protection which will be enjoyed by Ontario investors." In introducing Bill 7, the same minister stated that he was "optimistic that the Bill would establish the precedent for uniform securities legislation across Canada." See [1978] O.S.C.B. 52. The act was not implemented as a uniform act across Canada and therefore no "uniform act province" has been designated in the regulation.

94. Since the follow-up offer is stated to be "a take-over bid for the purposes of this Part", it appears that the provisions of the act, with respect to take-over bids generally, are applicable to the follow-up offer. If the follow-up offer itself must comply with the conditions in the act with respect to take-over bids, then it should be possible to take advantage of the provisions permitting conditional offers (para. 89(1)12). Thus, it is arguable that the follow-up offer could be made conditional on the tender of a specified minimum number of the outstanding securities of the offeree company. A question arises as to whether an offeror can maintain that it has satisfied its follow-up offer obligation under the act in circumstances where the offeror refuses to take up and pay for any securities deposited under the follow-up offer, on the ground that the specified minimum number of securities has not been tendered. This scenario could become a consideration in circumstances where a follow-up offer obligation exists and the offeror wishes to acquire one hundred percent of the voting securities of the target company. In these circumstances, a large shareholder might refuse to tender under the follow-up offer in order to bargain for consideration in excess of the private agreement consideration. On the other hand, the ability of an offeror to make a conditional follow-up offer could be used either to ensure that the offeror obtains all of the outstanding securities of the target company or to permit the offeror to argue that it has satisfied its obligation to make a follow-up offer, without having to take up and pay for any further securities.

This problem was considered in the Dome Energy Limited application for exemption from the obligation to make a follow-up offer for the outstanding shares of Hudson's Bay Oil and Gas Company Limited (HBOG). See *Re Hudson's Bay Oil and Gas Company Limited* (1981), 2 O.S.C.B. 44C; *Order* (1981), 2 O.S.C.B. 149B. It was Dome's intention to acquire all of the outstanding shares of HBOG, including a twelve-percent block held by the Hudsons Bay Company, while at the same time satisfying any follow-up offer obligation it might have had under the act. Although Dome advanced the argument for an exemption on the ground that it would be providing equivalent consideration under a plan of arrangement, it took the position that the OSC exempting order should provide that Dome had satisfied its follow-up obligation if the plan were put to the shareholders, even in circumstances where the plan was not approved by the shareholders. Counsel for Dome argued that the act could be interpreted to provide for the possibility of a conditional follow-up offer. The commission appeared to acknowledge that this argument could be made, but it was apparent that the commission would take the position, at least in exercising its discretion to grant an exempting order, that an offeror could only satisfy the follow-up offer obligation by taking up and paying for any and all securities tendered under the follow-up offer. Since the matter has never explicitly been the subject of a decision by the commission, the nature of conditions that may be imposed by an offeror seeking to satisfy a follow-up offer obligation remains uncertain.

Subsection 91(1) thus sets out four conditions which must be satisfied before the follow-up offer obligation arises: (1) there must be a take-over bid; (2) the take-over bid must be made by way of private agreement in reliance on the exemption in clause 88(2)(c); (3) there must be a published market in the class of securities acquired pursuant to the take-over bid; and (4) the offeror must have paid a consideration with a value in excess of the published market price on the market in which the securities of the offeree company are traded. "Market price" is defined in subsection 163(3) of the regulation as meaning, in general terms, the trading price plus fifteen percent.[95] The OSC has the power, under clause 99(b) of the act, to determine "[u]pon an application by an interested person or company" the market price (which may be different from the published market price) of the securities at any date where it has determined that the published market price was affected by an anticipated take-over bid or by improper manipulation.[96]

It was recognized that the enactment of the follow-up offer obligation in Ontario would not preclude avoidance of the obligation by the purchase of controlling shares made outside of Ontario, but it was expected that the obligation would be enforced nationally through the enactment of corresponding legislation in the

95. Section 163(3) of the regulation provides that "[f]or the purposes of subsection 91(1) of the Act, 'market price' of a class of securities on a particular date is an amount 15 percent in excess of the simple average of the closing price of securities of that class for each day on which there was a closing price and falling not more than ten business days before the relevant date (O. Reg. 190/80, s.27)." Reg., subs. 163(1), defines "closing price", and Reg., subs. 163(2), provides that where there are two published markets, the one with greatest volume should be used in the calculation. Reg., subs. 163(4), provides that there has to be a closing price for the securities within ten days, or else it is deemed that there is no published market.

96. "99. Upon an application by an interested person or company, the Commission may, subject to such terms and conditions as it may impose,

(b) where the Commission is satisfied that the market price of securities of any class determined in accordance with the regulations, by reference to the price of such securities as established by trades on a published market was affected by an anticipated take-over bid or by improper manipulation, determine the market price of such securities at any date, such determination to be based on a finding by the Commission as to the price at which a holder of securities of that class could reasonably have expected to dispose of his securities immediately prior to the relevant date excluding any change in price reasonably attributable to the anticipated take-over bid or to the improper manipulation..."

other provinces.[97] Thus, subsection 91(1) requires the follow-up offer to be made to "security holders, the last registered address of whom is in Ontario or in a uniform act province." Anisman and Hogg comment that:

> Given the policy implicit in the [act], even the requirement that the offer be made to securityholders in a uniform act province is an unsatisfactory halfway measure for unless all of the other provinces adopt the Ontario [act], the offeror may still exclude some of the minority shareholders; on a policy basis, therefore, it would have been preferable to have required the offer to be made at least to all shareholders resident in Canada.[98]

Subsection 91(2) provides that the follow-up offer obligation applies in circumstances where the purchaser acquires indirect control of an offeree company, pursuant to an arrangement established to avoid the follow-up offer obligation. If the purchaser acquires shares of a holding company established by a seller to hold shares of the public offeree company, then, if the holding corporation was established to avoid the follow-up offer obligation, the purchaser must make a follow-up offer for the shares of the offeree company, as it is the "true target company". A related provision, subsection 91(3), provides for equal consideration as follows: "Subject to any decision of the Commission under section 99, where a take-over bid or an issuer bid is made, all holders of the same class of securities shall be offered the same consideration and no collateral agreement with any such holders shall have the effect, directly or indirectly, of offering such holders a consideration of greater value for their securities than that offered to the other holders of the same class of securities." Section 99 includes grounds for an exemption from the follow-up offer obligation:

> Upon an application by an interested person[99] or company, the Commission may, subject to such terms and conditions as it may impose,

---

97. See, *supra*, note 93. See also Anisman, *The Proposals for a Securities Market Law for Canada: Purpose and Process* (1981), 19 Osgoode Hall L.J. 329 at p. 353; Emerson, "Business Finance Under the 'Closed System' of the Ontario Securities Act: Statutory Scheme and Pitfalls", in *Corporate Law in the 80s, Special Lectures of the Law Society of Upper Canada* 29, *supra*, note 67 at p. 30, n.3.

98. Anisman and Hogg, "Constitutional Aspects of Federal Securities Legislation", in *3 Proposals for a Securities Market Law for Canada* 135 (Ottawa: Minister of Supply and Services, 1979) at p. 150, n.72.

99. *Quaere* whether the director under the act could be considered to be an "interested person" so that the commission could initiate of its own motion a proceeding relating to the discretionary powers set out in section 99?

> (a) decide that an offeror shall not be obligated to comply with subsection 91(1) where the Commission finds that the offeror will not or did not acquire through the offer the power or authority to control the business or affairs of the offeree company;
>
> . . . .
>
> (c) decide for the purposes of section 91 that a consideration proposed to be offered by an offeror is, or is not, at least equal in value to the greatest consideration paid under the relevant agreements;
>
> (d) decide for the purposes of section 91 that a collateral agreement or arrangement with a selling security holder is made for reasons other than to increase the value of the consideration paid to him for his securities and may be entered into notwithstanding that section;
>
> (e) exempt any person or company from any requirements of Part where in its opinion it would not be prejudicial to the public interest to do so;[100]

In section 129, the act imposes a civil liability on an offeror who fails to make a required follow-up offer or to take up securities deposited thereunder where an obligation to do so exists under the act:

> An offeror who
>
> (a) does not make the offer to purchase required to be made by subsection 91(1) at a consideration having a value at least equal to that required thereby; or
>
> (b) does not take up securities duly deposited under the offer referred to in clause (a), is liable to pay to the security holders entitled to receive the offer to purchase, or whose duly deposited securities were not taken up, a consideration per security equal in value to the minimum consideration at which the offer is required

100. Since the onus is on the applicant and the OSC exercises considerable discretion as to whether or not an exemption order should issue, an offeror would generally be well advised to endeavour to negotiate a provision whereby its obligation to purchase under the private agreement would be conditional upon obtaining an exemption from the follow-up obligation. An application to the OSC for an exemption where such a conditional obligation to purchase exists might have a greater chance of success where the private agreement purchase has not been completed, given commission reluctance to issue rulings which have retroactive effect. See, for example, OSC Policy 2.1 E. (1982), 2 Can. Sec. L. Rep. (CCH) para. 54-903 at para. 6.

> by that subsection to be made, or to the excess thereof over the value of the consideration actually offered, together with damages, if any.[101]

The commission has three primary enforcement powers set out in Part XXII of the act. Under subsection 122(1), the commission can obtain an order for compliance:

> Where it appears to the Commission that any person or company has failed to comply with or is violating any decision or provision of this Act or the Regulations, the Commission may, notwithstanding the imposition of any penalty in respect of such non-compliance or violation and in addition to any other rights it may have, apply to a judge of the High Court for an order,
>
> (a) directing the person or company to comply with the decision or provision or restraining the person or company from violating the decision or provision; and
>
> (b) directing the directors and senior officers of the person or company to cause the person or company to comply with or to cease violating the decision or provision, and upon the application the judge may make such order, or such other order as he thinks fit.

In addition, where such action is, in its opinion, in the public interest, the commission may order, subject to terms and conditions it may impose, that trading shall cease in respect of any securities for such period as is specified in the order.[102] Alternatively, the commission can order that any and all exemptions contained in, inter alia, section 88 do not apply to a person or company named in the order.[103]

(b) *Policy Statements*

In addition to the act and regulations, one must also consider OSC policy statements and notices with respect to follow-up offers.[104]

---

101. The applicable limitation period, as set out in clause 135(b), provides that an action under section 129 must be commenced at the earlier of (i) 180 days after the plaintiff first had knowledge of the facts giving rise to the cause of action, or (ii) three years after the date of the transaction that gave rise to the cause of action.

102. Securities Act, R.S.O. 1980, c. 466, s. 123.

103. *Ibid*, s. 124.

104. See *Notice* "Re: Take-over Bids — Value of Consideration in Follow-up Offers" (1981), 2 O.S.C.B. 23A, concerning time value of money; Policy 9.2 "Take-Over Bids — Section 99 Applications for Exemptions from the Obligations [sic] to make a Follow-Up Offer" (1982), 2 Can. Sec. L. Rep. (CCH) para.

The OSC has stated that its policy statements do not have the force of law, but that they only indicate how the OSC intends to exercise its discretionary authority in certain circumstances.[105] In some instances, however, OSC policy statements may represent the OSC's interpretation of the law.[106]

In Policy 3-41,[107] the commission, in compliance with the instruction of the then minister,[108] formulated guidelines for the circumstances in which it would exercise its discretionary powers under section 99 of the act to provide exemptions from the follow-up offer obligation. The commission specified three categories which, it stated, had given rise to the policy concerns which resulted in the enactment of the follow-up offer obligation:

(a) A sale of control where the result is clearly unfair or abusive to the remaining shareholders;
(b) The sale of control follows a public distribution of equity securities of the same corporation (whether newly issued or derived from the control block) in which it may reasonably be assumed that investors relied on continued involvement of the controlling shareholder in the corporation's affairs, and the sale of control occurs within, say, ten years after the public distribution; or
(c) The offeror proposes obtaining effective control at a premium through purchases from fewer than fifteen shareholders, none of whom individually has effective control, at a premium unavailable to the remaining shareholders.[109]

The commission stated that if the sale of control did not fall within any of the three categories, it would "be favourably disposed to granting an exemption from the follow-up offer obligation", unless

54-961; Policy 9.3A "Private Agreements Prior to or During Take-Over Bid or Issuer Bid — Linked Transactions", *ibid,* paras. 54-962.

105. See Policy 1.1, "OSC Policy Statements — General" (1982), 2 Can. Sec. L. Rep. (CCH) para. 54-895, para. 2.

106. See, for example, Policy 9.3A, *supra,* note 104. See also Baillie, *supra,* note 69 at p. 30, noting that OSC policies are applied by practising lawyers as if they had the force of law.

107. "Take-over Bids — Section 99 Applications For Exemptions From the Obligation to Make a Follow-up Offer After a 'Control Block Premium' Transaction — The Securities Act, 1978", [1979] O.S.C.B. 232.

108. *Supra,* note 82.

109. *Supra,* note 107 at p. 237.

other circumstances indicated that the exemption would be contrary to the public interest.[110] Even if the sale did fall within one of the listed categories, the commission indicated that it might, under the following six special circumstances, grant an exemption:[111]

(a) where national economic policy favours repatriation of control;
(b) sale by an owner-manager to employees;
(c) where the non-controlling shareholders waive the offer;
(d) where a control block is transferred in a bona fide corporate reorganization where effective control of the block remains with the parent company but is held after the reorganization by an affiliate corporation;
(e) the offeror makes available to the other security holders the consideration required by subs. 91(1) by means that do not technically qualify as an offer such as an amalgamation, a winding up with a distribution to the security holders of cash or assets or if the follow-up offer is made by some other person which might not be the offeree corporation; and
(f) the offeror was required to purchase the control block without having made a voluntary decision to do so.[112]

Policy 3-41 therefore indicated that exemptions from the follow-up obligation could be expected to be granted, except in certain specific circumstances, thus greatly narrowing the thrust of the act.

The follow-up offer provisions of the act indicate that the legislature regarded the sale of control at a premium as being unfair to the remaining shareholders. It is therefore difficult to understand why the commission would be prepared to grant exemptions from the follow-up offer obligation in circumstances which would constitute a significant departure from legislation providing for the equal treatment of shareholders. The commission indicated that it

---

110. *Ibid.*
111. *Ibid,* at pp. 179-181.
112. For example, a regulatory agency which might order the disposition of shares, pursuant to a buy-sell agreement which permits the disposing party to "put" the shares to another shareholder at a price in excess of the market. This excessive price could arise pursuant to a formula, such as that regarding the calculation of book value, and the purchasing shareholder would not be in a position to select the price or determine whether or not he made the acquisition. This example and ground for exemption was suggested to the commission by the TSE. See *Submission of The Toronto Stock Exchange to the Ontario Securities Commission Concerning Section 91 of The Securities Act, 1978* (October 17, 1978) at p. 4.

would be favourably disposed to grant an exemption unless the result would be "clearly unfair or abusive to the remaining shareholders",[113] but the policy of the act indicates that a take-over bid at a premium by private agreement is, by its very nature, unfair unless followed by an offer to the minority. Moreover, the commission stated that, notwithstanding that a transaction fell within the three enumerated "special policy concerns", it would consider granting an exemption in six specific situations, which do not all appear to further the policy objectives of the follow-up offer obligation. Indeed, it appears that only (d) and (e) can reasonably be construed within the policy objectives of the act; examples (a) and (f) are unrelated to the policy concerns upon which the follow-up offer obligation is predicated, (b) appears to be a situation in which the follow-up offer should logically apply, and (c) would allow minority shareholders to be deprived of their right to a follow-up offer by a two-thirds majority vote of the minority. It is, therefore, not surprising that the policy was not adhered to by the commission under the chairmanship of Henry Knowles.[114]

V. *The Practical Application of the Follow-Up Offer Obligation: Administrative and Judicial Interpretation of the Act*

(a) *Jurisdiction and Extraterritorial Application of the Act*

(i) *Methods of Enforcing the Follow-up Offer Obligation*

Due to the fact that the other provinces did not enact the follow-up offer obligation[115] and because of the national character of many Canadian securities transactions, the OSC developed, in general terms, primarily three methods of enforcing the follow-up offer obligation so that the obligation would not be rendered nugatory by transactions taking place outside Ontario.[116] While the three

113. *Supra*, note 109, para. (a).
114. See, Baillie, *supra*, note 69, stating, at p. 32, that: "Policy 3-41 cannot now be relied upon as an indication of what exemptions will be granted." Policy 3.41 was not included in the revised OSC policies. See OSC Policy 9.2, *supra*, note 104.
115. But see recent legislative initiatives in Manitoba, Quebec, and British Columbia, *supra*, notes 9, 10, and 11.
116. Henry J. Knowles, Q.C., the then chairman of the OSC, commented on extraterritoriality in his 1981 Report (1982), 3 O.S.C.B. 79A, at p. 83A, as follows: "If the OSC ignores activities of non-residents that impact on the securities business in Ontario, then residents will incorporate outside Ontario for the purpose of avoiding Ontario law. If the OSC ignores the activities of Ontario

methods are not mutually exclusive, they can be broadly categorized as follows: (1) a broad interpretation of the act to find that a "take-over bid", as defined in the act, has been made, thus creating a follow-up offer obligation; (2) in the absence of a take-over bid, because of the lack of appropriate connecting factors with Ontario, enforcement of the follow-up offer obligation as a policy matter through the use, or threatened use, of cease trade orders under section 123 of the act or denial of exemption orders under section 124 of the act; and (3) a finding that a private agreement purchase which does not constitute a take-over bid, because, for example, of the purchase of less than twenty percent of the voting shares, is inextricably bound or linked to a subsequent or prior take-over bid, therefore requiring an equivalency of consideration for the whole transaction.

Broad Interpretation of the Act: In *Re Atco Ltd.*,[117] the commission held that Atco was obligated to make a follow-up offer to the minority shareholders of Canadian Utilities Limited (CU) in Ontario, notwithstanding the fact that Atco had purchased shares of CU from IU International Corporation (IU), whose address on the books of CU was not in Ontario, in a private transaction which took place in the United States or between the United States and Alberta. Prior to the private transaction, Atco had made a take-over bid for the shares of IU to Ontario shareholders, inter alia, in accordance with the act for the express purpose of exchanging the acquired IU shares for the CU shares owned by IU. The CU shares represented approximately fifty-eight percent of the outstanding CU shares. The rationale of the OSC for assuming jurisdiction was that Atco's offer to the shareholders of IU was made in Ontario at a time when Atco had an agreement with IU to exchange IU shares acquired under the offer for shares of CU, so as to constitute an indirect offer by Atco for CU, notwithstanding that there was no clear take-over bid under the first branch of clause 88(1)(k) of the act.[118] In a well-reasoned

residents that take place outside Ontario, then Ontario residents will structure their deals to take place in other than Ontario. In either case, the laws of Ontario will become meaningless. . ."

117. [1980] O.S.C.B. 412 (an application under clause 99(e) of the act for an order exempting Atco from making a follow-up offer to the remaining shareholders of the common shares of CU).

118. See, *supra*, at text accompanying note 94. The commission held that there was a take-over bid, on the ground that CU was the "other issuer" in the phrase ". . .to purchase . . . indirectly voting securities of the company or other issuer. . . ." As pointed out by Commissioner Thom in his dissent, the "other

dissent, Commissioner Thom rejected the argument that the transaction could come within subclause 88(1)(k)(ii)[119], as follows:

> The particular feature of subclause (ii), however, is that on its face there need not be an association with Ontario such as required by subclause (i). It was submitted, however, that in situations where neither party to the transaction was incorporated in, resided in or had an address in Ontario, the subclause would nevertheless be invoked where there were Ontario holders of securities of the offeree company.
>
> I am unable to accept the foregoing argument. Had the Legislature intended to enlarge the range of companies that might become involved in a take-over bid beyond that stipulated in the definition of the predecessor Act which is carried forward into subclause i of clause k, the appropriate action would have been to delete the words "the last address of any of whom as shown on the books of the offeree company or other issuer is in Ontario" in subclause i. A much more probable explanation of subclause ii is that it was included to supplement subclause i. Without subclause ii it would be possible for a company with a take-over intention to avoid becoming involved in the complications affecting the take-over bidder by arranging to have itself cast in the role of receiving rather than making the offer.
>
> With regard to take-over bids the policy of the Legislature of Ontario has been to restrict the range of its legislation to cases in which some at least of the offerees are within Ontario. This policy was expressed in two definitional paragraphs in the predecessor section 81, namely, clause c (now f), the definition of "offeree" and clause g (now k(i)). Clause c was not amended as would have been necessary had it been intended that under clause k(ii) there could be a take-over bid between an offeree and an offeror neither of whom had an address in Ontario.[120]

In *Re Caisse de Depot et Placement du Quebec,*[121] the commission made permanent a temporary section 124 order, denying certain exemptions, contained in the act, to the Caisse de

issuer" can only reasonably be interpreted to mean the other issuer referred to in the earlier part of the definition, ". . .the last address of any of whom is shown in the books of the offeree company or other issuer is in Ontario. . . ." As Commissioner Thom stated, *supra,* note 117 at pp. 426-427, "[t]he words other issuer do no more than extend the take-over definition to apply to an issuer that is not a company".

119. *Supra,* at text accompanying note 88.

120. *Re Atco Ltd., supra,* note 117 at pp. 428-429.

121. (1982), 4 O.S.C.B. 498C; a copy of the *Order,* issued under section 124, is published in (1982), 4 O.S.C.B. 290B. No follow-up offer was involved in this case.

Depot et Placement du Quebec (the "Caisse") for its failure to file insider trading reports and for an alleged illegal take-over bid for Domtar Inc. The Caisse, a Quebec crown agency, together with another Quebec crown agency, acquired some forty-two percent of Domtar, primarily from institutions. One of the institutions from which the Caisse purchased shares was Montreal Trust, which has its head office in Quebec. The Caisse dealt with Montreal Trust in Montreal, but Montreal Trust officers canvassed Ontario accounts to locate Domtar shares, with the result that shares were acquired from some Ontario accounts, the registered and beneficial owners of whom were resident in Ontario. After having obtained the Domtar shares from several accounts, Montreal Trust consolidated the shares into one certificate, in its name, for transfer to the Caisse.

The OSC held that the registration in Montreal Trust's name was transitory, so it could not be regarded as the "last address" of the offerees, which had, until the consolidation, included some Montreal Trust accounts in Ontario. Furthermore, the private agreement exemption was held unavailable because of subclause 88(2)(c)(i).[122] While the Caisse argued that it had dealt with only one party, Montreal Trust, the OSC held that more than fifteen parties had been involved, as at least fifteen of these accounts were found to be held in Ontario, and that, in tendering the Domtar shares to the head office of Montreal Trust, the Ontario managers and trustees were acting on behalf of the Ontario shareholders. Notwithstanding that the Caisse had made an agreement with Montreal Trust outside of Ontario, the substance of the transaction, rather than its form, governed. Thus, the Caisse was held to have made an illegal take-over bid to Ontario shareholders. In the circumstances of the case, the decision of the OSC is justifiable, since the Caisse appeared to be trying to do indirectly what it could not do directly. The evidence established that the Ontario accounts of Domtar shareholders, administered by Montreal Trust, were solicited by the head office of Montreal Trust. Ontario Montreal Trust managers acted on behalf of beneficial owners resident in Ontario, and the head office of Montreal Trust acted, in effect, on behalf of the Caisse.

In *Re Electra Investments (Canada) Limited,*[123] Electra acquired approximately forty-seven percent of the outstanding common

122. *Supra*, text following note 90.
123. (1983), 6 O.S.C.B. 417; a copy of the *Order*, issued under sections 123 and

shares of Energy and Precious Metals Inc. (EPM), a reporting issuer under the act, whose shares were listed and traded on the Montreal Exchange (ME). Electra had made its purchases of EPM shares through the facilities of the ME, which is not a recognized stock exchange for the purpose of an exempt stock exchange take-over bid. Electra marginally exceeded the ME's normal course purchase exemption of five percent in any month by purchasing, on two occasions, slightly more than five percent of the common shares of EPM in a thirty-day period from residents of Ontario who sold through the ME. The OSC decided that the cease trading order should remain in force, but that a denial of exemptions by a section 124 order under the act was inappropriate because the case should have been the subject of proceedings to obtain a compliance order, pursuant to section 122 of the act, to require compliance with the take-over bid requirements of the act. The OSC held that there was a take-over bid made from Ontario, by an Ontario resident, to Ontario registered shareholders, albeit through the facilities of the ME. The OSC stated that "[t]he legal question is an important one since it will determine whether the provisions for [sic] the Act could be circumvented . . . by listing the securities on an Exchange outside of Ontario or arranging for the offer to be made and accepted outside of Ontario."[124] The commission also suggested that the act should be amended to permit any shareholder, upon obtaining the consent of the OSC, direct access to the courts under section 122 of the act.

In the *Humboldt*[125] case, the commission appears to have decided to reverse somewhat the broad jurisdictional bases it had claimed in such cases as *Atco*[126] and *Electra*,[127] and it required that there clearly be a take-over bid, as defined in the act, in order for there to be a follow-up offer requirement. In this case, Humboldt Energy Corporation, a British Columbia corporation and a reporting issuer under the act, entered into an agreement with a Swiss corporation to purchase about 2.5 percent of the issued and outstanding common shares of an Alberta corporation, also a reporting issuer under the act, whose common shares were listed on the Vancouver and

124, is published in (1983), 5 O.S.C.B. 9B. No follow-up offer was involved in this case.
124. *Supra*, note 123, 6 O.S.C.B. 417, at p. 420.
125. *Re Humboldt Energy Corporation* (1983), 5 O.S.C.B. 8C.
126. *Supra*, note 117.
127. *Supra*, note 123.

Alberta stock exchanges at a price in excess of 15 percent of the market price. The address of the Swiss corporation, as it appeared on the books of the offeree corporation, was outside of Ontario. Approximately 33 percent of the offeree corporation's issued and outstanding capital was held by Ontario shareholders. The acquisition by Humboldt, together with the holdings of its controlling shareholder, would have exceeded the take-over bid threshhold of 20 percent under the act.

The commission stated that there was no "take-over bid", since the address of the Swiss corporation on the books of the offeree corporation was outside of Ontario and, therefore, the commission had no jurisdiction to give an exempting order under clause 99(e) of the act. The commission also stated that, in the circumstances of the case, it would not exercise any of its powers, including those under section 124, in order to compel Humboldt to make a follow-up offer to the offeree corporation's shareholders in Ontario. Although the commission said that it would not exercise its powers, including those under section 124, to compel a follow-up offer, it did state that it was in the process of developing guidelines of the circumstances in which it would consider exercising its powers in the act. In addition, it seemed to indicate that it was still of the view that it had a broad jurisdiction that might transcend provincial borders to force a follow-up offer, by stating that "[t]he Commission noted that private agreements, the terms of which, or the circumstances of execution of which, might be regarded as abusive to minority shareholders or as having a negative impact on the capital markets, could constitute the basis for Commission intervention."[128]

Enforcement as a Policy Matter: The OSC has forced follow-up offers and other provisions of the act in situations where issuers were not subject to the specific provisions of the act, on the ground that issuers that use Ontario capital markets, by reason of their listing on the TSE, or otherwise, should abide by the spirit of Ontario law. The OSC has pressured issuers to comply with the follow-up offer obligation, in cases where it may not be legally required, by exercising its powers to issue cease trading orders and orders denying exemptions in the act against the issuers and their officers and directors.[129] This policy was articulated in *Re*

128. *Re Humboldt Energy Corporation, supra,* note 125 at p. 9C.
129. Securities Act, R.S.O. 1980, c. 466, ss.123 and 124.

Cablecasting Limited,[130] where the commission stated that it would exercise its cease trading powers not only where a proposed transaction contravened a statute, such as the Business Corporations Act,[131] even where other remedies were available under that statute, but also where a transaction ". . .while consistent with the language of prior policy rulings and statements of the Commission, would contravene the intent of these rulings and statements and *detract from the credibility of the capital markets or be otherwise inconsistent with the best interests of investors*."[132]

In *Re Kaiser Resources Limited,*[133] the OSC found that the exercise of certain stock options by employees of Kaiser Resources Limited, a British Columbia corporation and a reporting issuer by virtue of its TSE listing, would have resulted in the breach of the insider trading provisions of the act.[134] Notwithstanding that the employees resided in British Columbia and the entire exercise of the options took place outside Ontario, the OSC asserted that it had jurisdiction, under section 124 of the act, to deprive the employees of trading exemptions available under section 34 of the act:

> It is. . .our view that activity by a person of the type prohibited by section 75, *wherever such activity takes place,* may properly form the basis for determination by the Commission pursuant to section 124 of the Act that it is in the public interest of this Province to deny that person the benefit of the exemptions contained in section 34 of the Act. *This is by no means to attempt to give an extra-territorial effect to the Act.* Rather, it is an assertion by the Commission of its jurisdiction and responsibility to determine the sorts of activity which should disentitle persons from trading, or restrict their ability to trade, in securities in this province. In so doing, the Commission is doing no more than carrying out its statutory obligation to supervise the capital markets of this Province.[135]

In *Re Universal Explorations Ltd.,*[136] the OSC issued various interim orders, under subsection 22(2), and sections 123 and 124 of

130. [1978] O.S.C.B. 37.
131. R.S.O. 1980, c.54 as am.
132. *Re Cablecasting Limited, supra,* note 130 at p. 41 (emphasis added).
133. (1981), 1 O.S.C.B. 13C.
134. Securities Act, R.S.O. 1980, c.466, s.75.
135. *Re Kaiser Resources Limited, supra,* note 133 at p. 16C (emphasis added).
136. (1981), 2 O.S.C.B. 33D (temporary cease trading order to prevent subsequent amalgamation); (1981), 2 O.S.C.B. 52D (extension of temporary order denying exemptions); *Re Universal Explorations (81) Ltd.* (1981), 2 O.S.C.B. 55D (extension of temporary cease trading order); (1981), 2 O.S.C.B. 57D (temporary denial of exemptions); (1981), 2 O.S.C.B. 59D (Notice of Hearing).

the act, in order to prevent an amalgamation of two Alberta corporations, Universal Explorations Ltd. and the Petrol & Gas Company Limited, notwithstanding that the amalgamation was subject to Alberta court approval. The order was issued as the amalgamation agreement might not have provided the remaining Petrol shareholders with the equivalent consideration as that paid by Universal for the control block of Petrol, pursuant to a private agreement from a Petrol shareholder resident outside of Ontario. Although the shares of the parties to the private agreement in which Universal acquired a control block in Petrol had never traded in Ontario, it appeared that the OSC was trying to force a follow-up offer to the remaining Petrol shareholders, on the ground that Petrol had been listed on the TSE for many years, there were some minority Petrol shareholders resident in Ontario, and, in announcing the proposed amalgamation of Universal and Petrol, Universal had issued a press release stating that it would make a follow-up offer to the minority Petrol shareholders.[137] The amalgamation agreement provided that minority Petrol shareholders would receive shares in the amalgamated corporation, which shares were to be listed on the TSE. The OSC's apparent rationale for claiming jurisdiction to issue its various interim orders was the fact that Universal would be using the Ontario capital markets to effect an amalgamation without making a follow-up offer.

The dissentient Petrol shareholders argued that the Alberta courts should not approve the transaction, as the OSC intervention might prevent a listing of the shares on the TSE. The Alberta court rejected this argument, stating that:

> [The] last ground of objection had to do with the position of the Ontario Securities Commission and the resulting impact on trading shares in Ontario, plus the use of the Toronto Stock Exchange. Frankly I consider this argument to be somewhat of a red herring in the context of this application. Universal and Petrol are both incorporated under the Alberta Companies Act and headquartered in Alberta. This application is under the Alberta Companies Act. [The transaction is a share exchange and amalgamation.] There is a substantial legal question as to whether this method of conversion constitutes a "trade" in shares under the Ontario Securities Act, for it is only when a trade occurs in Ontario that the Ontario Securities Commission obtains any jurisdiction over the matter. It is probably true that if

137. See, *infra*, note 138, 16 B.L.R. at p. 191.

> the new company wants to subsequently trade in Ontario, it will have to satisfy the Ontario Securities Commission that the proposal meets the Ontario criteria for a follow-up offer, but that is something that will have to be decided in the future by the Ontario authorities.[138]

In *Universal,* Universal's press release, stating that it would make a follow-up offer to minority shareholders, implicitly became a ground for the assumption of jurisdiction by the OSC.[139] In *Re Turbo Resources Limited,*[140] the OSC had occasion, once again, to consider the import of an undertaking to make a follow-up offer. On June 24, 1981, Turbo Resources Limited agreed to purchase, for $13-1/8 per share, about twenty-eight percent of the common shares of Merland Explorations Limited, which was owned by a company in the British Virgin Islands. A private agreement transaction was completed on July 3, 1981, outside of Ontario. This transaction did not constitute a take-over bid, as the address of the offeree shareholder was outside of Ontario. On June 27, 1981, the TSE accepted a notice of an offer by Turbo to make a stock exchange bid to acquire, through the TSE and the ME, a further twenty-seven percent of the Merland common shares for the same consideration per share as was paid under the private agreement.[141] The stock exchange bid was exempt from Part XIX of the act, other than subsection 91(1), pursuant to clause 88(2)(a). However, subsection 91(1) refers to "reliance on the exemption in clause 88(2)(c)", or

138. *Re Universal Explorations Ltd. and Petrol Oil and Gas Co. Ltd.* (1982), 16 B.L.R. 186 (Alta. Q.B.) at pp. 213-214; revd., on other grounds, *Harris* v. *Universal Explorations Ltd.* (1982), 17 B.L.R. 135 (Alta. C.A.) (approval for amalgamation denied on the ground of deficient disclosure in the information circular).

139. *Supra,* text at note 137.

140. (1982), 3 O.S.C.B. 14B (OSC order extending time for Turbo to make its follow-up offer); (1982), 3 O.S.C.B. 67C (reasons for first Bankeno Mines Limited offer); (1982), 3 O.S.C.B 57C (decision concerning second Bankeno offer); (1982), 3 O.S.C.B. 104C (reasons for decision for second Bankeno amended offer); (1982), 3 O.S.C.B. 65C (decision for July 9-10, 1981 hearing). See also (1982), 4 O.S.C.B. 403C (denial of exemptions pursuant to s.124); (1982), 3 O.S.C.B. 55C (Div. Ct.) (dismissal of application for an order of prohibition), (1982), 3 O.S.C.B. 132C (C.A.) (dismissal of application to extend time period for appeal from Div. Ct. order); *Re Turbo Resources Ltd. and Maison Placements Canada Inc.* (1982), 137 D.L.R. (3d) 264 (Ont. Div. Ct.), (1982), 19 B.L.R. 309; affg. (*sub. nom. Ontario Securities Commission* v. *Turbo Resources Limited*) (1982), 3 O.S.C.B. 98C (H.C.J.) (granting of compliance order under s.122) and affg. (1982), 3 O.S.C.B. 67C and 104C (decisions of OSC on first and second Bankeno valuation hearings).

141. TSE Notice to Members No. 3307, June 29, 1981.

the private agreement exemption, and does not include a reference to clause 88(2)(a). It would thus appear that a follow-up offer was not legally required as a result of the stock exchange bid.

The OSC held a hearing at the behest of Ontario Merland common shareholders who wanted the commission to order a follow-up offer. The commission did not order a follow-up offer under subsection 91(1) at that time, as it relied on an undertaking of Turbo to make a follow-up offer and requested that Turbo confirm its undertaking publicly. On July 8, 1981, Turbo announced what it termed a "clarifying statement" to the stock exchange bid, stating that, before December 29, 1981, it would effect or cause to be effected a transaction which would provide to the remaining shareholders of Merland the opportunity to receive a consideration per common share that was at least equal in value to $13-1/8.[142] The OSC did not make any order in July 1981, requiring Turbo to make a follow-up offer. Rather, it relied on the undertaking, and, in March 1982, when the offer was not forthcoming, it purported to give a written decision for the July hearing, claiming it had made an order requiring a follow-up offer.[143]

In March 1982, the OSC applied for a compliance order under section 122. Mr. Justice Osler stated that:

> After a hearing on July 9th and 10th the Commission made a decision not to prohibit the completion of the bid and an essential and integral part of that decision was the fact that the Commission received from counsel for the respondent, openly at its hearing and in the presence of the chairman, other officers and several directors of the respondent, an unconditional undertaking respecting the remaining shareholders. That undertaking in its essential part was that Turbo would effect or cause to be effected a transaction on or before December 29, 1981, which would provide to Canadian resident shareholders of Merland the opportunity to receive [$13-1/8] net of commissions per common share. That was the price at which the open stock exchange bids had been made.[144]

On appeal to the Divisional Court, Mr. Justice Southey said that:

> The Stock Exchange offer was for approximately 27% of the shares of Merland and was clearly a take-over bid under Part XIX . . . . It was exempted from the requirements of Part XIX

142. TSE Notice to Members No. 3318, July 9, 1981.

143. *Re Turbo Resources Limited* (1982), 3 O.S.C.B. 65C.

144. *Re Ontario Securities Commission and Turbo* (1982), 3 O.S.C.B. 98C (H.C.J.) at pp. 100C-101C.

> other than s-s.1 of s.91 by s.88(2)(a), because it was made through the facilities of a stock exchange recognized by the commission. . . .
>
> Under s.124 of the *Securities Act* the commission had the power "where in its opinion such action is in the public interest" to order that any or all of the exemptions contained in s.88 do not apply to a person named in the order. It was therefore open to the commission if, in its opinion, it was in the public interest to do so, to remove from Turbo the exemption under Part XIX relating to its take-over bid made through the Stock Exchange.
>
> The result of the removal of such exemption would have been to cause Turbo to be bound by s.91(3). . . .
>
> If s.91(3) had been made applicable to the take-over bid, it would have required Turbo to pay for all stock of Merland the cash consideration of $13 1/8 that it was paying under the Stock Exchange offer. But it then would have been open to the commission . . . to have modified the requirement imposed upon Turbo under s.91(3) by virtue of the powers given to the commission by s.99 of the Act. The commission could thereby have ordered Turbo to make a follow-up offer with a consideration at least equal in value to that originally paid, in accordance with s.91(1) in lieu of paying the same consideration as required by s.91(3). Such order would have required Turbo to do substantially the same thing as it has undertaken to do in its undertaking to the commission, and it seems reasonable to infer that the commission did not make any such order at the time of the July hearing because of the undertaking that had been given by Turbo.[145]

The court did not express a view as to whether the OSC was correct in its opinion that subsection 91(1) was applicable to Turbo.[146] However, Turbo had applied for an extension in December 1981, and the commission order, granting the requested exemption, stated that Turbo was subject to subsection 91(1).[147] Mr. Justice Southey stated that:

> Just as the commission for the reasons given above could have ordered Turbo at the July hearing to make an offer under s.91(1), it also had jurisdiction in December, for the same reasons to make the order contained in the proviso in para.1 that Turbo

145. *Re Turbo Resources Ltd. and Maison Placements Canada Inc.* (1982), 137 D.L.R. (3d) 264 (Ont. Div. Ct.) at pp.270-271; (1982), 19 B.L.R. 309 at pp. 316-317.
146. *Ibid,* D.L.R. at p. 271, B.L.R. at p. 318.
147. (1982), 3 O.S.C.B. 14B (para. 1 of the Order reads, in part, "the Offer pursuant to Section 91(1) of the Act shall be completed. . .").

> complete the offer under s.91(1) of the Act. The order there made, in our judgment, was an order with which compliance could be directed by a decision of a High Court judge.[148]

In *Turbo,* there was clearly no take-over bid in the private agreement transaction, because the offeree shareholder's address on the books of Merland was outside of Ontario. With respect to the stock exchange bid, the transaction was exempt from the requirements of Part XIX, other than subsection 91(1), by clause 88(2)(a). Subsection 91(1), however, becomes operative only where there is "reliance on the exemption in clause 88(2)(c)". A stock exchange bid is thus exempt from the follow-up offer obligation. An undertaking may provide shareholders with a contractual right of action, particularly where they tender pursuant to a stock exchange bid in reliance on the undertaking, but there does not appear to be any jurisdictional ground for the commission to mandate a follow-up offer on the basis of an undertaking. If *Turbo* had appealed the OSC extension order of December 1981, it might have done so with success.

It should not seem surprising that a stock exchange bid is exempt from the follow-up offer requirement of subsection 91(1). Except with respect to normal course purchases where a premium over market cannot be involved, such a bid is made pursuant to the rules of the exchange, with advance notice to all shareholders who have the right to participate in the acceptances of the offer so the mischief of the private agreement exemption is not present.

The Linked Bid: In February 1981, an OSC Notice stated that it might be contrary to the public interest for an offeror to acquire all of the holdings of certain shareholders through private agreements, and thereafter, in a "linked transaction", to offer for only part of the publicly-held shares.[149] In April 1981, the OSC issued an addendum to Interim Policy 3-37 which specifically refers to linked or integrated transactions:

> The Commission has been concerned that notwithstanding the intent of Part XIX of the Act, in some situations, holders of large blocks of shares may be or perceived to be treated better than the holders of smaller numbers of shares by the offeror in the context of a take-over bid or the issuer in the context of an issuer bid. It is

148. *Supra,* note 145, D.L.R. at p. 272, B.L.R. at p. 319.
149. Notices "Take-over Bids — Private Contracts — Partial Bids" (1982), 1 O.S.C.B. 6A.

> the policy of the Act [see section 91(3)] that all shareholders should be treated equally. Of concern particularly are partial take-over bids or issuer bids following or at the same time as private agreements for the purchase of all of the securities of the class sought from a particular holder.[150]

For the purpose of subsection 91(3) of the act, the OSC has stated that ". . .it is the view of the Commission that offering to purchase all the securities of a class of any holder pursuant to a private agreement will require that if the purchaser makes a linked or related take-over bid or issuer bid for the securities of that class, it must be made for all of the class of securities sought at a price at least as great as that paid in the private agreement."[151] With respect to private agreement purchases prior to making a take-over bid, the OSC stated that:

> If such private agreements constitute a take-over bid exempted from the requirements of Part XIX by clause 88(2)(c) and a follow-up offer is required pursuant to section 91(1), there appears to be no problem. But where the private agreements do not constitute a take-over bid or where it is exempted under 88(2)(c) and no follow-up offer is required to be made, the Commission is concerned for the equal treatment of the remaining shareholders during the subsequent take-over bid. It is the view of the Commission that when such private agreements are entered into by a purchaser with the intention of making a take-over bid at a later date, they should be considered in determining whether the same consideration is being offered to all holders of the same class of securities for the purpose of section 91(3). For this purpose, the Commission will presume that this intention existed at the time of the private agreement where the announcement of the take-over bid is made within 180 days of the date of the private agreement. This presumption may be rebutted upon an application under section 99.[152]

150. Addendum to Draft [Interim] Policy No. 3-37, "Private Agreements Prior To or During a Take-Over Bid or Issuer Bid" (1981), 1 O.S.C.B. 24E. A draft or interim policy may take effect from the date of its implementation with notice to the public that the policy may be modified to reflect comments received during the draft or interim period. See Request for Comments (1981), 1 O.S.C.B. at p. 25E. The addendum to the draft policy was essentially adopted by the OSC as Policy 9.3B. "Private Agreement Prior to a Take-over Bid or Issuer Bid — Linked Transactions" (1982), 4 O.S.C.B. 551 E, 2 Can. Sec. L. Rep. (CCH) para. 54-962.
151. Policy 9.3B., *supra,* note 150, O.S.C.B. at p. 552E, para. 2, 2 Can. Sec. L. Rep. at para. 54-962, para. 2.
152. *Ibid,* O.S.C.B. at para. 3, 2 Can. Sec. L. Rep. at para. 3.

In *Re Trans Mountain Pipeline Company Ltd.*,[153] the commission issued a cease trade order against a bid by Inland National Gas Co. Ltd. for Trans Mountain Pipeline Company Ltd., an act which is illustrative of the problems inherent in Policy 9.3B. Inland had purchased a block of Trans Mountain shares in a private transaction from Sovereign Life Assurance Company, whose address, on the books of Trans Mountain, was outside Ontario. The shares were purchased at a cash price of $9.04 per share prior to making, but after announcing, a take-over bid for Trans Mountain offering three Inland shares for five Trans Mountain shares. At a hearing in December 1982, the commission decided that if Inland were to proceed with its offer, it would not be required to offer cash of $9.04 per share. However, the commission held that the purchase from Sovereign was a "linked transaction" with the take-over bid, and it decided to cease trade the Inland bid until Inland offered paper of a value at least equivalent to $9.04 per share for each Trans Mountain share and sent two valuations of the consideration offered by the Inland take-over bid circular to Trans Mountain shareholders to substantiate the equivalency. Subsection 91(3) was held applicable, notwithstanding that the purchase from Sovereign was not a take-over bid. This interpretation of subsection 91(3) is, in effect, an assumption of jurisdiction by the OSC for transactions not legally subject to the act which have taken place outside of Ontario. The result of the order of the OSC in this case, from the point of view of the shareholders of Trans Mountain, was that the shareholders were to receive an offer of a value of at least $9.04 per share or, if Inland elected not to continue with its offer, no offer whatsoever.[154]

---

153. (1982), 4 O.S.C.B. 552C; a copy of the *Order,* issued under ss. 123 and 140, is published at p. 376B.

154. Inland subsequently continued with its offer, supported by two valuations that its offer was worth at least $9.04 per share. Trans Mountain challenged these valuations with two valuations of its own, which opined that the Inland offer was not worth $9.04 per share. After two days of hearings on the valuation question in January, 1983 (*Re Trans Mountain Pipeline Company Ltd.* (1983), 5 O.S.C.B. 5C), the commission, now differently constituted since Messrs. Knowles and Bray had ceased to hold office, decided to let the Trans Mountain shareholders determine for themselves whether or not they wanted to accept the Inland offer, regardless of whether it was worth $9.04 per share. As a result, the commission decided not to judge the differing valuations, but issued an exempting order, under section 99(e) of the act, permitting the offer to proceed, on the ground that to do so would not be contrary to the public interest.

The OSC has also considered the linked bid or intregration concept with respect to purchases after a take-over bid. In the *Genstar* case,[155] Genstar Corporation had made a bid for Canada Permanent Mortgage Corporation shares which expired on July 31, 1981, at a price per common share of $31.00 and a price of $36.90 per convertible series A shares. As a result of the bid, Genstar had acquired thirty-nine percent of the common shares on a fully converted basis. On August 10, 1981, Genstar purchased from its former adversary, First City Financial Corporation Ltd., all of First City's common shares of Canada Permanent for a price of $35.00 per common share and $41.65 per preference share. The commission reviewed the bids to ascertain whether the Genstar-First City agreement should be regarded as linked or integrally related in law, with the result that Genstar would be in breach of subsection 89(3) of the act. Subsection 89(3) provides that, where an offeror during the course of a take-over bid pays or agrees to pay a price for securities higher than the consideration offered through the bid, the take-over bid "shall be deemed to be varied by increasing the consideration to the higher price." The commission held that, since Genstar had decided to purchase First City shares only after the bid, the essential element of an integrated transaction was absent.

(ii) *General Considerations*

The legal question of the extraterritorial application of the act does not appear to have been the subject of judicial consideration. However, it is a general principle of Canadian law that provinces cannot legislate with extraterritorial effect. As stated in *Laskin's Canadian Constitutional Law:*

> Section 3 of the *Statute of Westminster* . . . expressly authorized Parliament to legislate with extraterritorial effect. . . .
>
> The terms of the *Statute of Westminster,* however, spoke expressly of "the Parliament of a Dominion", thus leaving unchanged the position of the Canadian provinces as well as of the Australian states. The beginning words of s.92 *B.N.A. Act,* reinforced by similar expressions internally for the listed classes of subjects therein and by like language in other section, *e.g.* Education, s.93, Agriculture, s.95, make it very plain that conduct beyond the borders of a province lies outside of provincial authority to regulate.[156]

155. *Re Genstar Corporation* (1982), 4 O.S.C.B. 326C, (1982), 20 B.L.R. 72.
156. Abel, Albert S., *Laskin's Canadian Constitutional Law* (4th Ed. Toronto: The Carswell Company Ltd., 1973) p. 408.

Ainsman and Hogg have commented that "...a province's jurisdiction is limited to persons, property or activities within its borders...the existence of some element in the province will not necessarily be sufficient to support regulatory legislation that modifies rights outside the province or that creates extra-territorial duties."[157]

The case law dealing with extraterritorial application of provincial legislation is generally concerned with the question of whether a particular provincial statute, the validity of which has been challenged, in fact operates so as to have extraterritorial effect. An examination of these cases indicates the apparent existence of a presumption against the extraterritorial application of provincial legislation: the courts will endeavour to interprete provincial laws so that they will not have extraterritorial application and, thus, will be within the power of a province.[158] A finding of statutory interference with extraprovincial rights generally results in courts declaring the legislation ultra vires as far as any extraterritorial application is concerned.[159] With respect to the commission's broad interpretation of its jurisdiction to mandate a follow-up offer obligation, the question is whether the commission's action in so doing involves destruction or modification of a civil or contractual right existing outside of the province of Ontario. In seeking to impose a follow-up offer obligation on a party to a private agreement where rights have been created outside of the province, it may be that the OSC is effectively modifying the rights of the affected party under the private agreement. In these circumstances, the courts might well find that the commission, in broadly interpreting the act, was giving it an extraterritorial application, and that the act should not be so interpreted.

The principle stated by the OSC in *Kaiser*[160] can be summarized on the basis that the conduct described in that case, which, if committed in Ontario, would have violated section 75 of the act, is improper, and that the OSC, in carrying out its statutory obligation

157. *Supra*, note 98 at p. 147.
158. See, for example, *Royal Bank of Canada* v. *The King*, [1913] A.C. 283 (P.C.); *Credit Foncier* v. *Ross*, [1937] 3 D.L.R. 365 (Alta. S.C. A.D.).
159. Hogg, Peter W., *Constitutional Law of Canada* (The Carswell Company Limited: Toronto, 1977) pp. 207-211. See also Commentary, *Do Unto Others: The Extraterritorial Reach of Regulatory Legislation in Canada* (1980), 5 Can. Bus. L. J. 114 at p. 126.
160. *Supra*, note 133.

to supervise the capital markets of Ontario, is entitled to deprive persons who engage in such improper conduct from trading in Ontario. Whether or not, as a matter of law, this principle is correct, it does not follow that the principle should be made applicable to create a follow-up offer obligation. It is difficult to argue that the obligation should apply to a transaction taking place in a jurisdiction which does not have a similar requirement. Until the commission publishes the proposed guidelines referred to in *Humboldt,*[161] however, uncertainty will remain as to the commission's view of its jurisdiction to exercise its powers in order to require a follow-up offer, notwithstanding that there may be no clear jurisdictional nexus under the act for a follow-up offer.

On the one hand, it can be argued that the commission has a broad jurisdictional basis to cease trade or remove exemptions under sections 123 and 124, as the powers thereunder are based on its opinion that action is required in the public interest. On this ground, it can be argued that the commission can exercise its powers to force a follow-up offer, notwithstanding that there is no take-over bid under the act, if, in its view of the public interest, a follow-up offer is required, due to the offeree corporation having Ontario shareholders or the offeree being a reporting issuer in Ontario or otherwise. On the other hand, it can be argued that, where the legislature has specifically provided in the act that a follow-up offer is only to be required where there is a take-over bid, as defined in the act, the commission should not exercise its powers to force a follow-up offer in circumstances where there is no take-over bid. Under this view, the language in sections 123 and 124 would have to be read in such a way as to make it consistent with the provisions of Part XIX of the act, and perhaps more generally in order to take account of the constitutional limitations of the province, so as to ensure no unlawful extraterritorial application of the act. The better view would appear to be that the commission should not exercise its powers under sections 123 or 124 where there is clearly no take-over bid in Ontario, since the legislature has expressed the circumstances in which the follow-up offer is to apply. Moreover, the purported exercise of its jurisdiction over transactions which legitimately take place beyond the borders of the province is constitutionally unsound. If the act were amended so that all take-over bids would be subject to Ontario law where the offeree

161. *Supra,* note 128.

corporation was a reporting issuer, it might be that the commission would have a broader power to intervene in order to protect shareholders of a reporting issuer. The reporting issuer jurisdictional base is already utilized in the act in such areas as insider trading, set out in Part XX, and in the proxy solicitation provisions, set out in Part XVIII.

In *Multiple Access Ltd.* v. *McCutcheon,*[162] it was held that the insider trading provisions of the act were intra vires and could operate concurrently with similar provisions under federal law. If the reporting issuer concept was utilized as the jurisdictional ground for take-over bids, it could arguably allow broader grounds for a follow-up offer to be mandated and could presumably operate concurrently with federal legislation in this area. On the other hand, it might be argued that such an amendment to the take-over bid definition under the Ontario Act would be ultra vires the province by forcing a follow-up offer where a corporate transaction takes place outside of the province.

(b) *The Application of the Exempting Power*

The formulation of a policy setting forth guidelines which indicate the grounds upon which the commission would be favourably disposed to grant an exemption from the follow-up offer obligation proved difficult.[163] The first application for an exemption from the follow-up offer obligation was heard by the commission after the departure of the chairman who had been responsible for Policy 3-41.[164] In *Re Ronalds-Federated Limited,*[165] the commission brought into question the whole import of the policy by denying the application for an exemption, notwithstanding that the commission had difficulty fitting the transaction within the ambit of three categories which it had stated would militate against granting an exemption. The commission decided to place the transaction within the first of the three categories as "unfair or abusive", rejecting arguments that the transaction should be exempt because the premium over "market" which triggered the follow-up offer obligation was an insignificant amount. The OSC held that the

162. *Supra*, note 13.
163. Report of the Vice-Chairman, OSC *Weekly Summary* 27, June 180 1A at p. 3A; See also Willis, *Canadian Administrative Law in Retrospect* (1974), 24 U. Toronto L.J. 225 at pp. 236-237.
164. Mr. J. C. Baillie.
165. [1980] O.S.C.B. 304.

special facts of the case, particularly the "very recent trading history, the relatively small float of Ronalds shares, the consequent thinness of the actual trading, the substantial premium that $30.00 represents over the trading price in the very recent past, and the price at which Ronalds Federated increased its control position through the TSE as recently as twelve months ago", made the transaction unfair to minority shareholders.[166] Although the commission stated that the issue was not one of the amount of the excess premium paid over the market price, the amount of the premium was given as a reason for denying the application. The OSC concluded that the case ". . .illustrates that a general policy statement such as 3-41. . .cannot cover all possible situations."[167]

In *Atco,* the vice-chairman stated that "OSC Policy 3-41, published prior to the coming into force of the Act in an attempt to give some guidance in a very vexing area, has taken on a life of its own in the eyes of some readers beyond that which at least some members of the Commission anticipated."[168] The granting of an exemption in *Atco*, notwithstanding that the transaction contained some elements which could be construed as being unfair in the context of *Ronalds-Federated,* created uncertainty as to the criteria which the OSC would consider important in the exercise of its discretionary powers to grant exemptions. In particular, the transaction appeared abusive and unfair because IU had acted on the basis of what was best for it as a majority shareholder, and had done so by rejecting the proposed take-over bid at a slightly lower price to all of the offeree corporation's shareholders so that it could obtain a greater price in a private transaction.[169]

The commission had stated in *Ronalds-Federated* that the size of the premium should be irrelevant, but in *Atco* this factor was taken into account, as follows: "The excess premium being paid is not on its face so large as to be clearly unfair or abusive to the other shareholders and the other factors present also do not indicate that the transaction is clearly unfair or abusive."[170] It also appears that the fact that control of a major Canadian company was being repatriated to Canadian hands had some effect, although this issue was questioned by counsel for the minority shareholders, who asked

166. *Ibid,* p. 314.
167. *Ibid.*
168. *Supra,* note 117 at p. 424.
169. *Ibid,* at p. 422.
170. *Ibid.*

"how a payment of some $320 million to a United States corporation could be in Canada's best national interest."[171] In another decision, namely, *Re Sands Oil & Gas Exploration Limited*,[172] in which the commission granted an exemption, the applicant represented that it proposed to convert inactive corporations into active concerns for the probable benefit of the shareholders. The application was granted without reasons for the decision and, therefore, without reference to *Ronalds-Federated*.

Guideline (e) of Policy 3-41 suggested that an exemption might be granted, under clause 99(e) of the act, from the follow-up offer obligation "[i]f the 'offeror' makes available to the other security holders the consideration required by section 91(1) by means that do not technically qualify as an offer . . . ."[173] In *Sklar*,[174] PCL Industries Limited proposed that it make a premium payment to "top up" the market value of the Sklar Manufacturing Limited common shares in order to give a shareholder a package of securities which would have a value, taken together with the common share itself, that was equal to the consideration paid under the private agreement. The shareholder would be topped up from the market value without his shares actually being acquired. The commission noted that the topping-up proposal had merit, since ". . .one of the undesirable consequences of fulfilling the 'follow-up offer' obligation is the removal of the subject securities of the charter company from the range of securities available to the public."[175] The commission stated that it would consider a topping-up proposal, "carried forward on a timely basis", as an adequate ground to grant an exemption from the follow-up offer obligation under clause 99(e) if certain circumstances existed. These circumstances were that:

(a) the intention to make a "topping-up" distribution is publicly announced on the day the private agreement is made and announced,

(b) the market for the target securities at the time of such announcement was not "affected by an anticipated take-over bid or by improper manipulation" [section 99(b)],

171. *Ibid*, at p. 421.
172. (1981), 2 O.S.C.B. 188B.
173. *Supra*, note 107 at pp. 239-240.
174. *Re PCL Industries Limited/Sklar Manufacturing Limited* (1982), 4 O.S.C.B. 27C. See also *Re Sklar Manufacturing Limited, infra*, note 200.
175. *PCL/Sklar, supra*, note 174 at p. 31C.

(c) the "topping-up" distribution clearly has the same "value" as the premium paid under the private agreement, e.g.

(i) cash, where the seller under the private agreement receives cash, or

(ii) the same securities as received by the seller under the private agreement where the seller receives securities, and

(d) the "topping-up" distribution is made at the same time as, or within five to ten business days from, the date of payment under the private agreement.[176]

Presumably, the restriction that the offer be made within five to ten business days was imposed so that the question of value would be easier to determine. We think that such a limited period of time may unduly restrict the use of topping-up proposals. The process of topping-up should be available if made within the statutory period of time for the follow-up offer, which, at present, is 180 days, with the value being determined by the OSC if it appears that the total value is not at least equivalent to the consideration paid under the private agreement.

The commission cast doubt on the effect and import of Policy 3-41, but allowed it to stand as the commission's statement of the grounds on which it would exercise its discretion in granting exemptions, while giving it perfunctory or no consideration in later cases.[177] It is regrettable that the commission did not readdress the policy issues in order to revise Policy 3-41 when it became apparent from the result of the first decision in *Ronalds-Federated* that the policy would not be applied by the commission. This fact was not formally recognized until the end of 1982, when the policy was deleted from the OSC Policy statements.[178]

(c) *Non-Acquisition of Effective Control*

The act assumes that control is acquired when the twenty percent threshhold is achieved, but provides that this assumption can be rebutted under a clause 99(a) application, where the OSC determines that an offeror will not or did not acquire the power or authority to control the business or affairs of an offeree company as

176. *Ibid*, pp. 32C-33C.
177. See, for example, *PCL/Sklar, supra*, note 174.
178. Policy 9.2 "Take-over Bids — Section 99 Applications for Exemptions from the Obligations [sic] to Make A Follow-up Offer" (1982), 4 O.S.C.B. 550E, 2 Can. Sec. L. Rep. (CCH) para. 54-961.

a result of the take-over bid.[179] In Policy 3-41, the OSC stated that substantial weight would be given to whether the offeror would, as a consequence of the private agreement transactions, acquire the practical authority to nominate (and presumably elect) a majority of the directors.[180] This exemption is a logical one within the context of the policy for the follow-up offer: where the offeror has not in fact paid a premium to acquire control, the offeror should not be obliged to make an offer to all shareholders.

Although clause 99(a) is expressed in the act as a separate ground for granting an exemption, the former chairman of the commission indicated in *Re Dataline Inc.*[181] that it should consider clause 99(e) in tandum with clause 99(a). On this basis, once the commission has made a determination under clause 99(a) that is favourable to an offeror, it would then further consider whether an exemption would not also be prejudicial to the public interest. This raises the issue of whether it was intended that the follow-up obligation would only apply where control, de facto or legal, is being acquired or whether it was intended that, in any case where a private agreement exemption is being utilized to exempt a take-over bid and a premium in excess of fifteen percent is involved, the act was intended to apply. We believe that a good argument can be made for the position that the follow-up obligation was, as a general rule, intended to apply only when the acquisition of control is involved. Since it is very often difficult to judge whether control is in fact being acquired, the technique used was to provide that a take-over bid at the required premium would trigger the operation of subsection 91(3), but that the commission would have power to exempt where it is satisfied that the offeror has not or will not acquire control.

Noranda Mines Limited and Alberta Energy Company Limited (AEC) applied to the OSC under clauses 99(a) and (e) when Noranda sold its block of twenty-eight percent of British Columbia Forest Products Limited (BCFP) outstanding common shares to AEC.[182] The applicants submitted that effective control of BCFP

179. See text accompanying note 100, *supra*.
180. *Supra,* note 107 at p. 236.
181. (1982), 3 O.S.C.B. 48C, at pp. 52C-53C.
182. *Re British Columbia Forest Products Limited (Part II)* (1981), 2 O.S.C.B. 6C; *Order* (1981), 1 O.S.C.B. 177B. The OSC had previously determined under clause 99(b) that the market price of the shares of BCFP had been affected by an anticipated take-over bid, thus giving rise to consideration of whether a follow-up

would not reside with AEC, but with a control group composed of AEC and two American corporations holding together a block of about forty-one percent of BCFP's outstanding common shares. The evidence indicated that the principal shareholders had always acted collectively, without having any voting or other agreements, to nominate and have elected one-half of the total number of directors of BCFP, and that this arrangement would continue. Moreover, the management of BCFP and the Minister of Forests for British Columbia required that AEC and the American controllers enter into a standstill agreement with BCFP, under which they agreed not to change their pro rata interests for a period of ten years. It was the evidence of BCFP, and the view of the minister, that AEC would not acquire control of BCFP when it completed its purchase of the Noranda block. The OSC granted the requested exemption from the follow-up offer obligation on the condition that AEC consent to a section 124 order, denying AEC the exemptions from the take-over bid requirements of the act with respect to BCFP. Thus, in the event of a change in the position of the government of British Columbia or in the event that BCFP's management permitted AEC to increase its holdings in BCFP, such an increase would be effected only in Ontario, in compliance with the take-over bid requirements of the act, including a follow-up offer to BCFP's Ontario shareholders. It is difficult, however, to see how the obligation to comply with the take-over bid requirements of the act could accrue at an undetermined date in the future.

In *Re Dataline Inc.*,[183] an employee fund and retirement plan acquired a thirty-four percent block of Dataline Inc. in a single transaction, under circumstances that required a follow-up offer or an exempting order. A block of over fifty percent of Dataline shares was held by a holding company which was owned by the president and chief executive officer of Dataline; thus, he had the power to control the affairs of Dataline and to elect a majority of its directors. This majority shareholder arranged for the sale of the other block, representing thirty-four percent of the Dataline shares, to the fund and the plan. The purchasers acquiring the block submitted that they were passive investors with no interest in management or representation on the board. The majority of the OSC decided that the fund and the plan acquired no power or authority to control

offer was required to be made by AEC. See *Re British Columbia Forest Products Limited* (1981), 1 O.S.C.B. 116C.

183. *Supra*, note 181.

Dataline through the purchase, as the power and control remained where it had been prior to the private agreement purchase — that is, with the majority shareholder. In a dissent, the chairman held that a thirty-four percent holding of the voting securities carried with it an element of "power or authority to control" the company, since it in effect gave the fund and plan, as a matter of corporate law, veto power over fundamental changes in the corporation.[184] Although such veto power can affect the affairs of a company, we believe that the most reasonable interpretation to be placed on clause 99(a) in the context of this situation would be that effective control means the ability to elect the board of directors. Furthermore, the former chairman argued that consideration of clause 99(a) required consideration of clause 99(e), and that the public interest demanded, in a case where the thirty-four percent had been sold to the plan and fund through the intermediation of the fifty-one percent controller, leaving a small public float, that the application be declined.[185]

In *Ronalds-Federated,*[186] Newsco Investments Limited tried to argue under clause 99(a) that, since Newsco exercised control over F.P. Publications Limited (FP) equally with four other shareholders and since FP controlled Ronalds-Federated Limited (Ronalds), the purchase from FP by Newsco of the Ronalds shares did not constitute the acquisition of control of Ronalds. Newsco had been one of five shareholders that each held about 23 percent of the shares of FP, and FP owned 51.6 percent of Ronalds. Newsco sold its 23-percent interest in FP to Thomson Newspapers Limited and purchased FP's 51.6-percent interest in Ronalds. The commission interpreted clause 99(a) directly with reference to Policy 3-41, indicating that it would look to whether the agreement had led to the acquisition of the practical authority to nominate a majority of the directors. The commission held that Newsco did acquire control of Ronalds through its direct holding of 51.6 percent of the common shares of Ronalds, as opposed to its indirect control, which amount to about 11.6 percent of Ronalds through a 23-percent shareholding of a corporation owning 51.6 percent of Ronalds.

In *McLaughlin,*[187] the commission refused an application, under clauses 99(a) and (e), wherein the offeror increased its sharehold-

184. *Ibid,* at pp. 52C-54C.
185. *Ibid,* at pp. 52C-53C.
186. *Supra,* note 165.
187. *Re McLaughlin and S.B. McLaughlin Associates Ltd.* (1981), 1 O.S.C.B. 98C, (1981), 14 B.L.R. 46.

ings in a corporation which was already effectively controlled by him. McLaughlin owned 49.6 percent of the shares of S.B. McLaughlin Associates Ltd. on a fully diluted basis. He purchased additional shares from two other shareholders by private agreement in order to bring his total holdings to 54.3 percent, again on a fully diluted basis. The price paid for the shares under the private agreement was such that a follow-up offer was required. McLaughlin adduced no evidence as to the reason for paying a premium over the market price for the shares acquired by private agreement, and gave no reason why the requested exemption should be granted, arguing simply that he did not acquire through the purchase the power or authority to control the business or affairs of the offeree company, since he already had effective control. It was submitted that the policy resulting in the enactment of section 91 was premised upon the acquisition of effective control at a premium.[188]

The commission rejected McLaughlin's submissions regarding the policy of the legislation and stated that take-over bids are not restricted to control bids, pointing out that "section 91(1) extends to all take-over bids regardless of whether the offeror is seeking control or already has control."[189] After describing the evolution of securities legislation leading up to the follow-up offer and after analyzing the provisions of the act, the commission stated that the thrust of the act was towards evenhanded treatment among security holders of the same class.[190] The Divisional Court upheld the decision of the OSC as to the exercise of its discretion to refuse to grant McLaughlin an exemption, and stated that ". . .one of the objects of the Act is the protection of minority shareholders. In our view, that protection may well be as much needed where the take-over bidder has already acquired control as it is where he is acquiring control through the take-over bid."[191]

The Interim Take-Over Bid Review Report analyzed the effect of *McLaughlin* in the context of the legislative history of the follow-up offer obligation, and concluded that it was not appropriate to impose a follow-up offer obligation where a transaction solely involved a

188. *Supra*, note 187, B.L.R. at pp. 52-53.
189. *Ibid*, at p.53.
190. *Ibid*, at p. 61.
191. *Re McLaughlin and Ontario Securities Commission* (1981), 128 D.L.R. (3d) 256 (Ont. Div. Ct.) at p. 258 (leave to appeal to the Court of Appeal denied on November 16, 1981). See also note 223, *infra*.

consolidation of a pre-existing control position.[192] The Review Committee argued that the follow-up offer obligation was not designed as, nor should it be converted into, a remedy to cure perceived insider trading abuses by controlling persons. The committee recommended that the follow-up offer obligation be triggered only by an acquisition of effective control and that effective control be defined, for the purposes of subsection 91(1), as being "the power to exercise a controlling influence over the business and affairs of the offeree company."[193] Accordingly, the Review Committee would argue that the ability to influence the direction of the management and policy of a company is not enhanced when a holder of effective control increases his shareholdings, and, in these circumstances, no follow-up offer obligation should be required.

The Review Committee supported its position by stating that the OSC has provided protection for minority shareholders in the context of insider bids and going private or similar transactions through Policy 3-37 and related policy initiatives where it has imposed requirements for a valuation and independent or unaffiliated shareholder approval. In other circumstances, such as amalgamations where there is no going private element, the committee submitted that corporate laws and related jurisprudence have been effective in protecting minority shareholders' rights through adequate disclosure in information circulars and the obligation to demonstrate fairness, by statutory dissenting shareholders' appraisals rights, by the determination of fair value by the courts, and by injunctive relief.[194]

The central issue discussed by the Review Committee was whether or not the purchase or sale of control should be a necessary prerequisite to the follow-up offer obligation. The implicit assumption of the take-over bid threshhold is that the acquisition of a twenty-percent holding involves the acquisition of effective control.[195] In our view, where an application for an exemption is made under clause 99(a), the act should, as a legal matter, be

192. Interim Take-Over Bid Review Report, *supra*, note 16 at pp. 214A and 226A.

193. *Ibid*, at p. 226A.

194. *Ibid*, at p. 227A.

195. Securities Act, R.S.O. 1980, c. 466, subpara. 1(1)11(iii) (twenty percent is, in the absence of evidence to the contrary, deemed to affect materially the control of the issuer).

interpreted as requiring a follow-up offer only where control, de facto or legal, is actually being acquired, unless the application for the exemption reveals special circumstances which lead the commission to reach the conclusion that the result of granting the exemption order would be oppressive to the minority shareholders.

(d) *Equivalent Consideration: Form and Value*

Once it is established that a follow-up offer obligation exists under the act, an offeror must offer "a consideration per security at least equal in value to the greatest consideration paid" under one or more of the prior private agreements entered into by the offeror.[196] The offeror is thus required to first value the private agreement consideration; then the follow-up consideration must be at least equal in value to the private agreement consideration.

(i) *The Private Agreement Consideration*

The Allowable Premium: When a purchaser makes a take-over bid by private agreement, the seller of shares is allowed only up to a fifteen-percent premium; otherwise, a follow-up offer obligation on the part of the purchaser is created.[197] The OSC has stated that any premium above the fifteen-percent level, no matter how minimal, is an unacceptable premium, and that the size of a premium over the fifteen-percent level is not a governing factor in determining the fairness to minority shareholders in granting an exemption from the follow-up requirement. In *Ronalds-Federated,* the OSC rejected the argument that a clause 99(e) exemption should be granted because of the "insignificant amount" of the excess premium: ". . .once one pays a price that exceeds the market price, regardless of how small that excess is, a follow-up offer is required . . . . to concentrate on the size of the premium paid once the price paid exceeds the defined market price as being the most relevant factor in seeking an exemption is to start from the wrong premise. Once an excess premium is paid a follow-up offer is mandated."[198]

The fifteen-percent premium threshhold is an arbitrary figure, but with fairness to the policy-makers, the line had to be drawn at some point and fifteen percent appears to be a reasonable figure. The

196. *Supra,* text accompanying note 94.
197. *Supra,* note 95.
198. *Re Ronalds-Federated Limited, supra,* note 165 at p. 311. See also, for example, *Re Atco Limited, supra,* note 117 at p. 419.

Review Committee has suggested that the required distribution to shareholders in a follow-up offer should perhaps be the portion of the premium in excess of fifteen-percent in order to give recognition to the fact that a fifteen-percent premium has been deemed acceptable by the Lieutenant Governor in Council, and that a sharing of the premium was necessary only to the extent that the premium exceeded the amount which the Lieutenant Governor in Council allowed.[199]

Brokerage Fees or Commissions: In calculating the "market price", the OSC has decided that the "reasonable brokerage fees or other commissions" permitted by subsection 91(1) should be included only where such brokerage fees or commissions are actually paid. Where no fees or commissions are paid as part of the private agreement, there should not be a notional calculation of what such fees would have been if the transaction had taken place on the stock exchange.[200]

Cash or Securities: Where the private agreement effecting the take-over bid is a cash transaction, there does not appear to be any dispute as to the value of the private agreement consideration; the value of the private agreement consideration will be equal to the face value of the cash amount paid. Where securities have formed part or all of the consideration in the private agreement, it would appear that the relevant date, under subsection 91(1) of the act, for determining the value of the private agreement consideration is the date of the private agreement. In addition, the value of such securities would be the market price, if any, as of the date of the private agreement, assuming that normal market trading conditions prevailed as of such date. Where the private agreement consideration paid by the offeror consists in whole or in part of securities which were originally acquired by the offeror at a cost in excess of the market price of those securities at the date of the private agreement, additional complications arise. This situation arose in the *Atco*[201] and *Dome Energy Limited*[202] cases, which suggest that, where a large block of securities is involved and the block has been recently acquired, the best evidence of the market value of the securities paid under the private agreement in normal circumstances

199. See "Interim Take-Over Bid Review Report", *supra*, note 16 at p. 235A.
200. See, for example, *Ronalds-Federated*, *supra*, note 165, pp. 307-308; *Re Sklar Manufacturing Limited* (1982), 3 O.S.C.B. 120C at p. 123C.
201. *Supra*, note 117.
202. *Supra*, note 94.

is the cost of such securities to the offeror, rather than the closing price of such securities at the date of the private agreement.

Market Price: The commission has the power to make a discretionary determination of the market price, pursuant to clause 99(b) of the act, to ensure that collateral agreements do not have the effect of offering certain holders a consideration of greater value than other holders and to ensure that the market price has not been affected by rumours of an anticipated take-over bid or improper manipulation.[203] In making a determination under clause 99(b) that the market price of securities was affected by an anticipated take-over bid or by improper manipulation, the OSC has stated the purpose of the clause as follows: ". . .to ensure that when there has been a disposition of securities at a premium the determination of whether or not that premium exceeds the 'market price' will be made in a comparison of a representative base so that minority security holders will not have been intentionally deprived of their rateable share of the control premium."[204] The OSC also indicated that it would exercise caution when making determinations under clause 99(b): ". . .[t]he Commission will be cautious when exercising its discretion under section 99(b) to make a determination of 'market price' that is different from that calculated in accordance with [Reg. s.163] in a situation where a vendor (or purchaser) may have been lured into a false sense of security, i.e., that the published market prices reflect the auction market's perception of the actual exchange market value of the subject security."[205]

The commission also has the power to make determinations under subsection 91(3) and clause 99(d) of the act as to whether collateral agreements or arrangements result in a security holder receiving greater consideration than other security holders. The commission must make two determinations: first, whether an offeree indirectly received a consideration for his securities through the collateral agreements of a greater value than that received by the other shareholders, and second, whether such agreements were made for reasons other than to increase the value to be paid to the shareholder

203. Securities Act, R.S.O. 1980, c. 466, subs. 91(3), clauses 99(d) and (b).
204. *Re British Columbia Forest Products Limited* (1981), 1 O.S.C.B. 116C at p. 120C; (the commission found that the trading price of the BCFP shares on the TSE was affected by an anticipated take-over bid, and therefore set the market price at a figure which would have required a follow-up offer). An exemption was ultimately granted: *Re British Columbia Forest Products Limited (Part II), supra*, note 182.
205. *Re British Columbia Forest Products Limited, supra*, note 204 at p. 120C.

by the offeror. A question may arise as to whether factors personal to offerees, such as income tax benefits, should be taken into account in determining the value to be attributed to the private agreement consideration. The plain meaning of the language in subsection 91(1) referring to "the greatest consideration *paid*" arguably supports the proposition that such personal factors should not be taken into account, since the use of the word "paid", rather than the word "received", seems to reflect a recognition that an objective standard must be used to determine the value of the private agreement consideration.

In *Re Royal Trustco Limited,*[206] the commission did find that a collateral agreement had the effect of offering a party to a private agreement a consideration greater than that offered to the other shareholders. The agreement through which the Royal Trustco Limited shares of Unicorp Financial Corporation were obtained by Campeau Corporation permitted an alternative whereby Unicorp would have a right of conversion, as well as other benefits under a shareholders agreement, not available to other shareholders. The commission also alluded to the fact that Unicorp was seeking a tax-free roll-over of its shares into Campeau shares which would not be available to other shareholders.

In the *Labatt and Dominion Dairies* case,[207] John Labatt Limited acquired, by a private agreement, the shares of Dominion Dairies Limited held by Dart & Kraft, Inc. and it acquired further shares of Dominion Dairies by a second private agreement. Labatt then proposed to make a take-over bid for all of the remaining Dominion Dairies shares, offering the shareholders the same consideration that had been paid under the private agreements. Labatt had also entered into collateral agreements with Dart for a trademark licensing agreement and for a computer services agreement by which Dominion Dairies would continue to have the right to use trademarks owned by Dart and to receive computer services that had been provided by Dart. The commission determined that these collateral agreements "were bargained at arm's length between the parties as an essential element of a continuing commercial relationship between [the offeree corporation and the selling majority shareholder]", and were made for reasons other than to

206. [1980] O.S.C.B. 465.
207. *Re John Labatt Limited and Dominion Dairies Limited* (1981), 2 O.S.C.B. 1C; *Order* (1981), 1 O.S.C.B. 189B.

increase the value of the consideration to be paid to Dart for its Dominion Dairies shares.[208]

(ii) *The Follow-Up Consideration*

Value: The second step in determining whether an offeror has satisfied the equivalent consideration requirement is to determine the value of the follow-up consideration. As in the case of private agreement consideration, where a cash follow-up offer is made, the value of the follow-up consideration would be the amount of cash offered per share. Where, however, all or part of the follow-up consideration consists of securities, the determination of the value of the follow-up consideration is more complicated.

In considering applications for exemptions from the requirements of subsection 91(3), namely, that all holders of the same class of securities be offered the "same consideration" on a take-over bid, the OSC has dealt with the question of equivalency of cash and noncash consideration. In the *Torstar*[209] case, Torstar Corporation proposed to offer $30 cash per share to nonresident Canadian Harlequin Enterprises Limited shareholders. For every three Harlequin shares, it tendered $60 cash, one Torstar warrant, and one Torstar preference share to Canadian resident Harlequin shareholders, so as to avoid conflict with Canadian ownership constraints contained in Torstar's articles and to avoid registration of the securities with the U.S. Securities and Exchange Commission. The OSC held that "same" consideration, within the meaning of subsection 91(3), means "identical" consideration.[210] The commission did not make a specific finding that the two offers were of equivalent value and, indeed, noted that "the package offered would have different attractions, positive or negative, to each offeree."[211] The commission did, however, give considerable weight to the opinions of the investment advisors who testified that the offers were equivalent in value, and the commission made it clear that the value was to be the market value at the time of the offer, subject to market variations.[212]

208. *Ibid*, at pp. 4C and 190B.
209. *Re Torstar Corporation, and Harlequin Enterprises Limited* (1981), 1 O.S.C.B. 62C; *Order* (1981), 1 O.S.C.B. 113B.
210. *Ibid*, at p. 65C. *Accord, Re Trans Mountain Pipeline Company Ltd.* (1983), 5 O.S.C.B. 5C at p. 5C.
211. *Supra*, note 209 at p. 70C.
212. *Ibid*, at pp. 70C and 71C.

The facts of the *Labatt*[213] case are similar to those of *Torstar*. Labatt offered Canadian shareholders the option of Labatt common shares or cash, and offered non-Canadian shareholders cash only. The commission determined that unequal consideration was proposed to be offered, since, based on the market prices, the value of Labatt shares offered was greater than the cash being offered to non-Canadian shareholders. The commission appears to have held that the relevant value of the securities offered was the market value of such securities at the time of the initiation of the take-over bid.

In *Turbo*,[214] the commission held that, where securities are offered, they are to be valued at their market price on the day that the follow-up offer is made; the commission explicitly rejected the submission that "value" should be regarded as "net asset value", rather than market price, saying that:

> In order that equality in value between the consideration paid on the take-over bid and the consideration offered in the Offer may be assessed in this case, where the consideration paid in the take-over bid was paid in actual dollars, the value of the consideration offered in the Offer, not being paid in dollars, must be expressed in dollars. The Commission can come to no other conclusion in the present case but that the conversion of the value of the securities into dollars can only be effected by determining what the market price of those securities would be at the date of the Offer. In the present case, the price paid for the shares *acquired for cash* in the course of the take-over bid and the *value* of the securities offered in the Offer must be susceptible to direct comparison. In this case, only the market price that would be paid for the follow-up offer securities, the Bankeno Units, can determine their value.[215]

The commission confirmed this decision in an amended offer hearing, where it rejected the weighted analysis approach which would combine asset and market value elements to arrive at a value. It held that ". . .the 'value' of the consideration under the follow-up offer. . .must be determined by the 'market price' of that consideration (or, where, as in the present case, there is no established market, the best approximation of what that 'market price, would be). Section 91(1) and the terms of Turbo's

213. *Supra*, note 207.

214. See, *supra*, note 140.

215. *Re Turbo Resources Limited* (1982), 3 O.S.C.B. 67C at p. 85C. Southey J. stated in (1982), 137 D.L.R., *supra*, note 140 at pp. 273-274, that: "We are in complete agreement with this application and interpretation of s.91(1) of the Securities Act. . .by the commission".

undertaking both require that a comparison be made between the 'value' of the consideration offered in each of two transactions, namely, the take-over bid and the follow-up offer."[216] The commission's decision to apply only market value was affirmed by the Supreme Court of Ontario,[217] and was confirmed by the commission in the *Sklar*[218] case, where the commission adopted the reasoning in its decision on the amended Turbo offer.

Economic Factors and Equivalency: In a notice issued in 1981, the OSC stated that it would take into consideration "the variation, if any, in (i) the value of the consideration paid under the private agreement, and (ii) the value of the consideration proposed to be offered under the follow-up offer, resulting from the operation of economic factors between the date of the private agreement and the date of the follow-up offer".[219] The commission's authority to invoke "economic factors", including the time value of money, is not apparent, based on the plain meaning of the language in subsection 91(1) and clause 99(c) of the act. It is reasonable to argue that such factors should not be considered, so long as the follow-up offer is made within the 180-day period specifically provided for in the act. On the other hand, it may be conceded that, if the follow-up offer is not made within the 180-day period, it would be fair to add some consideration to reflect the value of consideration from the date of the expiry of the 180-day period.

In *Re Ziebart Corporation,*[220] the commission expressly required an offeror to reflect the time value of money to satisfy the equivalent consideration requirement of subsection 91(1) of the act. In that case, the commission permitted the offeror to defer its follow-up offer beyond the 180-day period, pending the resolution of certain outstanding issues, on the condition that the offeror make a cash follow-up offer in an amount equal to the purchase price paid under the private agreement, plus interest, as defined in the Judicature Act.[221] The interest was to be paid on the purchase price from the date the follow-up offer obligation came into effect under the act — that is, 180 days from the date of the private agreement to the date

216. *Re Turbo Resources Limited* (1982), 3 O.S.C.B. 104C at p. 116C.
217. (1982) 137 D.L.R. (3d) 264 (Ont. Div. Ct.), (1982), 19 B.L.R. 309.
218. *Re Sklar Manufacturing Limited* (1982), 3 O.S.C.B. 120C, at p. 130C.
219. Notice "Re: Take-Over Bids — Value of Consideration in Follow-Up Offers" (1981), 2 O.S.C.B. 23A.
220. (1981), 1 O.S.C.B. 5B.
221. R.S.O. 1980, c.223, as am.

that the securities would first be taken up under the deferred follow-up offer. The commission also required account to be taken of the time value of the consideration, under clause 99(c), in the *Canada Permanent*[222] case.

In *McLaughlin,*[223] the question of economic factors was considered by Boland J., who stated that:

> On March 15, 1981 [the 180th day after the private agreement transaction], the right to an offer for $12.24 per share crystallized and shareholders who wished to accept an offer were denied the possibility and in effect had been denied the use of the proceeds since that date.
>
> It is reasonable to assume that such shareholders would probably have reinvested the proceeds and realized some return. This should be taken into account when considering the appropriate value for the proposed offer. Other factors such as inflation, tax implications, numerous fluctuations in the market and in interest rates over the past year, and the circumstances of the case in question are also matters which could be considered when deciding upon the appropriate value of the follow-up offer.[224]

The question of the time value of money and other economic factors were not addressed in the decisions of the Divisional Court or the Court of Appeal, and Madame Justice Boland's statements on this matter were not expressly overruled or otherwise varied.[225]

It appears that the OSC has only considered economic factors that relate to the time value of money from the date the follow-up offer obligation comes into effect until the date the actual follow-up offer is made. It is not apparent what other economic factors, if any, the OSC would apply. Logically, one would assume that changes in the value of the target corporation during this period should also be taken into account. Thus, if an offeror uses its common shares to buy shares from a private agreement vendor at a time when its

---

222. *Re Canada Permanent Mortgage Corporation* (1981), 2 O.S.C.B. 85B. First City Financial Corporation Ltd. had not at the time determined the date or precise terms of the follow-up offer it was required to make. See also *Re Turbo Resources Limited* (1982), O.S.C.B. 67C at pp. 85C - 86C (first valuation hearing).

223. *Ontario Securities Commission* v. *McLaughlin* (1983), 40 O.R. (2d) 405 (Ont. C.A.); revg., in part, (1982), 38 O.R. (2d) 390 (Div. Ct.), (1982), 137 D.L.R. (3d) 613, (1982), 18 B.L.R. 241; affg. (1981), 35 O.R. (2d) 11 (H.C.J.), (1981), 130 D.L.R. (3d) 632, (1981), 16 B.L.R. 82 (compliance order issued pursuant to s.122 of the act upheld).

224. *Ontario Securities Commission* v. *McLaughlin* (1982), 35 O.R. (2d) 11 (Div.Ct.) at p. 14.

225. See, *supra,* note 223.

shares are trading at $12 per share and if, at the time of the follow-up offer, its shares are trading at $24 per share, one would assume that, subject to the trading value of such shares being affected by the market in light of the pending take-over bid, only half as many shares would be required to satisfy the follow-up obligation. Conversely, twice as many shares would be needed if the value went from $12 to $6. As a practical matter, the market for the shares of a target corporation will likely be affected by the obligation to make a follow-up offer, so there may be little, if any, drop in the trading price of the shares of the target in the usual case. However, if there is a drop in the value of both the offeror and the target during the period, then it would appear unfair to require only the offeror and its shareholders to be at risk.

(iii) *To Whom the Offer is Made*

Where the follow-up offer is made within the specified 180-day period following the date of the first agreement, it appears that no problem would arise regarding to whom the offer should be made: the offer would be made to the shareholders who held shares at the time the offer was made within the 180-day period. Where the offer is not made within the 180-day period and the offeror makes a voluntary offer or is ordered to do so subsequent to the expiration of the 180-day period, a question arises as to whether the offer is to be made to the shareholders at the time the offer is made or whether it should be made to the shareholders as at the expiration of the 180-day period.

In *Turbo,*[226] the Ontario Divisional Court upheld the compliance order, granted by Mr. Justice Osler, which required that Turbo provide to the shareholders, at the time the follow-up offer is made, the equivalent follow-up offer consideration as paid under the stock exchange bid. In *McLaughlin,* however, the Ontario Court of Appeal held that those entitled to receive the follow-up offer are the security holders whose last registered address is in Ontario on the expiration of the 180-day period:

> . . .[T]he section is clear: the only persons entitled to receive the follow-up offer are those who meet the two conditions precedent on the day the follow-up offer is made, if made before the expiration of the 180-day period, and if not made within that time, then those who meet the two conditions precedent on the

226. *Supra,* note 140.

> day when the 180-day period ends. At that time the class is closed. Of importance, this meaning is the only one which is consistent with the words of s.129. . .which provides liability to the security holders for failure to make the follow-up offer required by s.91(1).
>
> The offeror cannot change the class by failing to make the offer within the time directed by the statute, whether the failure is the result of a decision to seek advantages from market change or otherwise. Nor has the Court any discretion in the matter. The scheme of the Act is simply that the follow-up offer must be made to those who are qualified at a specified time, and the Court may at the suit of the Commission direct that which should have been done to be done.[227]

Thus, the court held that if a security holder sold his securities before the offer was, in fact, made at a price below that at which the follow-up offer should have been made, he could claim under s.129 for his loss, together with damages.

We believe that the interpretation of the statue by the Ontario Court of Appeal is correct, but that the act should be amended to state that the offer should be made to shareholders holding shares on the date such offer is made, so that the right to receive the offer would follow the shares in order to recognize the realities of the marketplace. The *McLaughlin* case raises the question of whether shareholders who sell their shares before the offer is made would have to repurchase shares to tender to the offer or whether they could simply be entitled to accept the difference between the follow-up consideration and the price for which they sold their shares. It would certainly be complicated and unreasonable for shareholders to have to repurchase shares, thus incurring additional brokerage costs, in order to tender to the follow-up offer.

(e) *Liability for Breach of the Follow-Up Offer Obligation*

Section 129 of the act,[228] which has not been the subject of judicial determination, provides that an offeror who fails to make a follow-up offer at an equivalent consideration or to take up securities duly deposited under a follow-up offer is liable to pay the minimum consideration required under subsection 91(1) or the amount of the excess of the minimum consideration at which the

227. *Ontario Securities Commission* v. *McLaughlin* (1983), 40 O.R. (2d) 405 (Ont. C.A.) at p. 409.
228. *Supra*, text accompanying note 101.

offer is required to be made under subsection 91(1) over the value of the consideration actually offered, and is also liable for any damages. The act does not, however, indicate whether the offeror would be entitled to receive the securities in respect of which the follow-up offer obligation originally existed. Presumably, a court would order the transfer of the shares to the offeror who has been held liable under s.129, since to not do so would result in an unjustifiable enrichment by the offeree at the expense of the offeror and because any prejudice caused by the offeror's failure to comply with the act could be compensated for by awarding damages.

In *McLaughlin,* it was argued that the court should not make an order under s.122 requiring compliance, because liability for failure to meet the requirements of subsection 91(1) is specifically provided for in section 129 by way of a personal remedy to the security holder. It was contended that the act should be interpreted as excluding the application of the general enforcement section, namely, s.122, in the absence of clear language in the act that the general provision should apply in addition to the specific remedy under s.129. The Court of Appeal rejected this argument, stating that: ". . .s.129 is not intended to be an exclusive remedy. It is part of a scheme to ensure that there is a follow-up offer, and to secure the benefits which should be enjoyed by those entitled to receive it."[229] The fact that the general compliance remedy can apply, notwithstanding the specific remedy in the act, is important, particularly in the context of the requirement for a follow-up offer on the basis of an undertaking, as in the *Turbo* case. Section 129 requires as a condition that an offer must be required to be made by subsection 91(1), and it is arguable that there is no subsection 91(1) requirement where there is a mere undertaking. In *Turbo,* therefore, s.129 might not be available to Merland minority shareholders. The validity of s.122, notwithstanding that it is a general enforcement provision, whereas s.129 is a specific enforcement remedy, becomes crucial to shareholders who might not have had a remedy under s.129, due to there being no subsection 91(1) obligation, but, rather, an undertaking being enforced by the commission.

VI. *Conclusions and Suggestions for Reform*

It is perhaps unfortunate that the initial Ontario experience with the follow-up offer obligation was gained in the midst of a very deep

229. *Supra,* note 227 at p. 9.

and prolonged recession. Economic conditions created strains which made the survival of this shareholder equal treatment experiment doubtful.

Securities markets are not confined within provincial boundaries. The Ontario experience with the follow-up offer obligation has demonstrated the importance in a federal system of achieving some agreement among the provinces for a uniform approach to the problem of the sale of control. In our view, it is not feasible or desirable, in the current environment, for the problem to be dealt with through securities regulation by the federal government. It would be helpful, however, if the federal government were to revise the take-over bid provisions contained in Part XIX of the CBCA to provide for an equal treatment rule for control premiums when the target corporation is subject to the CBCA on the same model as adopted by the provinces.

One must then ask whether the Ontario follow-up offer obligation should continue as the equal treatment rule or whether it should be revised. We make the following observations:

1. We think that the most important aspect of this matter is agreement among the provinces and the federal government with respect to CBCA target corporations regarding the form of equal treatment legislation to deal with the control premium problem. Since securities markets are not confined to provincial boundaries, a uniform approach to the problem is perhaps more important than the actual legislative technique used to deal with the matter. If a particular province should decide, as a matter of public policy, that it is not prepared to legislate equal treatment for control premiums, then that province would have to recognize that the legislation in other provinces would, for the most part, regulate control premium transactions except those within that province which were primarily local in nature.

2. We have concluded that the preferable approach is that employed by Quebec, whereby the private agreement exemption is removed so that take-over bids have to be pro rata.[230] In general

230. The SEC Tender Offer Committee would require a tender offer to be made at the 20% threshhold level regardless of whether or not a premium for control was involved. Subject to whatever discretionary exemptive power might be retained by the SEC, there would be no exemption for stock exchange or private agreement purchases. See, *supra*, note 3.

terms, we would deal with the matter by revising the Ontario follow-up offer obligation as follows:

(a) The private agreement exemption should be removed except where the premium paid on the take-over bid is less than a specified amount. The specified amount could be fifteen percent, which is the amount of the premium currently applicable to trigger a follow-up offer obligation. In the alternative, the amount could be higher. If one approaches the problem from the perspective that it is only substantial premiums which should be prohibited by legislation, then it would be possible to justify a considerably higher premium as the cutoff point. Additionally, if one were concerned about unduly impeding take-over bids, it might be possible to justify a considerably higher premium before the private agreement exemption is removed.

(b) The exemption from the follow-up offer obligation for stock exchange take-over bids should continue.[231]

(c) Should the private agreement exemption be removed for all take-over bids or only those where control, de facto or legal, is actually being acquired? If one were of the view that the mischief related to the premium for control, then the exemption should arguably be removed only where control is acquired. Since it is difficult to determine whether control will in fact be acquired, however, we would be inclined to maintain the twenty-percent threshhold, but make it clear that, in the absence of unusual circumstances, the commission should exempt the transaction. The commission should permit the private agreement exemption to be expanded where it is satisfied that control is not, in fact, being acquired and the premium is not, in fact, being paid for control or as part of a plan to move towards control.

(d) The situation where the offeror already has de facto or legal control so that it cannot be said that he is acquiring control is one that causes some difficulty from a policy point of view. Where the offeror does not own or control at least two-thirds of the votes so as to be able to cause fundamental corporate changes to take place it cannot be said in normal circumstances that he completely

231. See the text following note 148, *supra*. The exemption for normal course purchases on a stock exchange at the rate of 5% of the outstanding shares every 30 days is too broad an exemption and should be narrowed to more closely circumscribe the potential for creeping take-over bids.

controls the corporation. To a lesser extent the same can be said when any minority exists because of the remedies available to minorities as a matter of law for breach of fiduciary duty, oppression or otherwise. On balance we are inclined to the view that the private agreement exemption should be available for further purchases once the offeror holds two-thirds or more of the voting shares.

(e) With respect to the jurisdictional nexus for the application of the equal treatment law, consideration might be given to making a bid subject to Ontario law where the offeree corporation is a reporting issuer in Ontario. We believe, however, that the current approach in Ontario, and that adopted by Quebec, namely, of a bid being subject to the act where an offer is made to a resident within the province, should be maintained, as it is perhaps the soundest approach from a constitutional point of view.

(f) The commission should have the power to exempt transactions on the condition that a follow-up offer of the same amount or equivalent value will, in fact, be made on such terms and conditions as are satisfactory to the commission.

(g) The unconditional exempting power of the commission should be continued, but should be granted only in extraordinary cases.

(h) The possibility of exempting orders where an offeror offers a topping-up should be recognized. It might even be desirable to legislate this exemption, although the provisions for the commission to determine the real premium, where the market has been affected by an anticipated take-over bid or by improper manipulation, and for it to determine the effect of collateral agreements or arrangements would have to be continued.

(i) A question arises as to whether the obligation of the offeror to minority shareholders should relate to the entire premium or merely to the portion of the premium in excess of the permitted premium. In our view, once the specified premium is exceeded, the private agreement exemption would be removed. It should still be possible, however, for the commission to grant an exemption in appropriate cases, conditional on a topping-up for the entire premium or only for the portion of the premium in excess of the specified amount.

(j) A question remains as to how nonvoting or restricted voting, but participating, shares should be treated. We concur with the views of the TSE, which has stated the following: "It would be harmful to the credibility of the trading markets for control to change hands at a premium under a sale of one class of residual equity shares, probably held by a restricted group of holders, when no bid is made for publicly distributed residual equity shares with lesser (or no) voting rights. The real questions lie in what should be done to meet the situation."[232] The premium relates to control and, therefore, should perhaps logically apply only to voting shares. Perhaps, as a matter of corporate law, there should be limits on the creation of nonvoting participating shares. Alternatively, provision should perhaps be made to ensure the inclusion of nonvoting residual equity shares when a take-over bid is made for the full voting shares.

(k) The legislation, with respect to collateral agreements in clause 99(d) and subsection 91(3), should be amended to make it explicit that the standard should be an objective one and that factors personal to offerees should not be considered in a determination of whether a collateral agreement has had the effect of increasing the consideration paid to an offeree.

(l) We suggest that section 99 of the act be amended so that it explicitly gives the OSC power to bring on an application of its own accord, since the current language of an "interested person or company" would seem to exclude the Director under the act from taking the initiative.

232. *The Toronto Stock Exchange Submission to the Ontario Securities Commission Concerning the Regulation of Non-Voting, Multiple Voting and Restricted Voting Common Shares* (September 1981) p. 16; TSE Notice to Members No. 3560, April 14, 1982, "Re: The Toronto Stock Exchange's Policy Statement on Restricted Shares", Appendix A, p. 1.