Toronto, June 17, 2003

By Courier

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, ON M5H 3S8

Dear Mr. Stevenson:

Request for Comments –
Proposed Amended Rule 61-501

We are writing in response to the request for comments regarding proposed amended OSC Rule 61-501 (the "**Rule**") published under cover of a notice dated February 28, 2003. A diskette (in Word format) containing a copy of this letter is enclosed.

Our comments are confined to the proposed addition to the Rule of a new definition of "collateral benefit" (the "**proposed collateral benefit rule**") and consequential amendments. More particularly, as discussed below, we believe the proposed collateral benefit rule should not be implemented and the current collateral benefit provisions in the Rule (the "**current collateral benefit rule**") should remain in place.

General

The intention behind the proposed collateral benefit rule is essentially to require, in the case of a going private type transaction (arm's length or not), that minority approval be obtained if a related party shareholder is involved in a collateral agreement (including one previously agreed to) that the other shareholders are not also involved in. Where this is the case, the related party shareholder's shares would be excluded from a minority vote. The proposed collateral benefit rule provides certain exceptions to the above including where the benefit to be received by the related party shareholder is employment related, is reasonably consistent with customary industry practice, is not conditional on the shareholder supporting the transaction and the shareholder together with all other related party shareholders who are involved in collateral agreements (and associated persons) do not own more than 10% of the outstanding shares.

In contrast to the proposed collateral benefit rule, the current collateral benefit rule does not result in the exclusion of a benefiting related party shareholder's shares from a minority vote unless the benefit being received by the shareholder is "*consideration of greater value*" than that to be paid to all other shareholders. The concept "*consideration of greater value*" is taken from section 97(2) of the *Securities Act* (Ontario) (the "**Act**") (the "**collateral benefit rule in the Act**"). Under the collateral benefit rule in the Act, a collateral agreement (a "**collateral**

agreement") is not considered consideration of greater value if it is determined (either by the parties involved in the transaction or through a ruling of the Ontario Securities Commission (the "**Commission**")) that the collateral agreement is for reasons other than to increase the value of the consideration paid to the shareholder for his or her shares. Accordingly, based on the collateral benefit rule in the Act, under the current collateral benefit rule a related party shareholder can enter into a collateral agreement in connection with a going private type transaction without triggering a minority approval, and/or without having to exclude his or her shares from the minority vote, provided it is determined that the collateral agreement is for reasons other than to increase the value of the consideration paid for his or her shares.

It is our view that it was intended by the Commission that the current collateral benefit rule (for going private transactions) be the same as the collateral benefit rule in the Act (for take-over bids). It is our further view that there is no reasonable basis for drawing a distinction between the two acquisition rules. Therefore, the proposed collateral benefit rule should not be implemented.

The current collateral benefit rule was intended,
and is, the same as the collateral benefit rule in the Act

The current collateral benefit rule is contained in clause (c)(i)(B) of the definition of "interested party", subparagraph (e)(ii) of the definition of "going private transaction" and the minority approval requirements in paragraph 8 of the Rule. The question to be answered in each case is whether a related party shareholder will receive "*consideration of greater value*" than that paid to all other shareholders as a consequence of the transaction. If so, an arm's length transaction becomes a going private transaction and the shares of the benefiting shareholder are excluded from the minority vote or, alternatively, such shares are excluded from the minority vote in a transaction which is already for other purposes deemed to be a going private transaction.

The concept "*consideration of greater value*", which is fundamental to the current collateral benefit rule, is the same concept used in subsection 97(2) of the Act:

- The current collateral benefit rule was first introduced in the second draft of the Rule which was published for comment in January 1999 (the "**January 1999 Draft Rule**"). Footnote 39 to the January 1999 Draft Rule states that "the concept of consideration of greater value is derived from subsection 97(2) of the Act".

- Section 2.13 of the companion policy to the Rule (the "**Policy**"), which section was first introduced in the draft Policy that accompanied the third draft of the Rule (published for comment in December 1999), states as follows:

> 2.13 **Collateral Benefit** – (1) A number of provisions in the Rule turn on whether a particular security holder is receiving consideration of greater value than that received by or paid to other security holders.
>
> (2) The Commission notes that the words "consideration of greater value" are found in subsection 97(2) of the Act, which subsection contains what is commonly referred to as the "collateral benefit rule".

> (3) Decisions considering subsection 97(2) of the Act may be of assistance in interpreting the relevant provisions in the rule.

If the Commission intended that the current collateral benefit rule be different than the collateral benefit rule in the Act, the concept ("*consideration of greater value*") used in subsection 97(2) of the Act would not have been transported into the Rule. In any event, at a minimum, the Policy could readily have eliminated any potential confusion to be caused by the use of the same concept in the Rule as contained in subsection 97(2) of the Act by (i) stating that subsection 97(2) and the decisions thereunder will not be of assistance in considering the current collateral benefit rule since the test under the Rule differs from the test under the Act, and (ii) setting out the specific test to be used in the Rule. In fact, subsection 2.13(3) of the Rule, which states that "Decisions considering subsection 97(2) of the Act may be of assistance in interpreting the relevant provisions in the rule", confirms that decisions considering subsection 97(2) may be of use, depending on the facts in any given circumstance.

The collateral benefit rule in the Act recognizes the commercial necessity of permitting certain collateral agreements

Subsection 97(2) of the Act provides that no one shareholder shall enter into a collateral agreement with an offeror that has the effect of providing the shareholder with consideration of greater value than that to be received by the other shareholders.

Through the years the Commission has granted numerous exemptions from the collateral benefit rule in the Act pursuant to paragraph 104(2)(a). Generally speaking, exemptive relief has been granted where the Commission is satisfied that the terms of a collateral agreement are commercially reasonable and the agreement is made for reasons other than to increase the value of the share consideration to be paid to that shareholder (collectively, the "**Test**").

The parameters of subsection 97(2) were considered extensively in *CDC Life Sciences Inc.*, June 17, 1988 O.S.C.B. 2541, where the Commission had the following to say:

> During the course of the hearing questions were raised as to what sorts of collateral agreements, commitments or understandings might be entered into without creating a breach of subsection 96(2) [now 97(2)]. Such collateral agreements are both many and various, and each will be considered on its own facts. Mr. Sorell filed a helpful compendium of decisions in which the Commission has considered such agreements, and a common thread runs through most of them: a clearly established business or financial purpose related either to the terms upon which the offeror is prepared to acquire the target company or to its ongoing operation. Thus, the Commission has approved agreements under which certain shareholders would receive deferred compensation rather than immediate cash; others, requiring the controlling shareholders to take certain assets out of the company as a condition of the offeror's proceeding; yet others, providing for continuity of senior management by way of employment contracts. In each case, staff has tested the reasonableness of the arrangement in relation to the purpose claimed for it and independent opinions on that issue have sometimes been required.

Where a collateral agreement meets the Test, the Commission has granted exemptive relief regardless of the particular percentage of shares that the shareholder subject to the agreement holds in the target issuer and regardless of the quantum of the consideration being offered to the

shareholder under the agreement vis-à-vis the share consideration to be received by the shareholder for his or her shares. Most importantly, the Commission has recognized that collateral agreements can be, and often are, integral commercial components of acquisition transactions and not necessarily disguised share consideration.

The collateral benefit concepts in the Act and the Rule should remain the same

We believe that the underlying policy premise for take-over bids in the Act and going private transactions in the Rule (both being a form of acquisition transaction) is the same: all shareholders should be treated the same in respect of their shareholdings and no one shareholder should be party to a collateral agreement unless it is for reasons other than to increase the value of the share consideration to be paid to that shareholder. The two rules only part ways, and should only part ways, if it is determined that a collateral agreement is a collateral benefit: under the current collateral benefit rule in the Act, such a determination would result in the take-over bid being prohibited from proceeding whereas such determination in the context of a going private type transaction would result in the transaction being able to proceed provided minority approval (excluding the differently treated shareholder) is obtained. Accordingly, the same test should be applied under the Act and under the Rule to consider the threshold question of whether a collateral agreement is or is not a collateral benefit.

Call the concern "unequal treatment" under the Act or "conflicts of interest" under the Rule, it is the same in both cases, being a concern that a shareholder who is receiving a collateral benefit is presumed not to have the same common interests as the general body of shareholders and therefore should not be able to tender shares or vote, as the case may be, along with the others unless the Commission determines in any particular circumstance that the Test has been met, the presumption rebutted and the exemptive relief forthcoming.

In providing exemptive relief, the Commission has recognized the commercial role of collateral agreements and has accepted the necessary role the Commission must play in overseeing take-over bids where collateral agreements are involved and making a determination as to the nature of a collateral agreement. The Rule is not any more or any differently concerned with the consequences of conflicts of interest than are the take-over bid rules in the Act. Accordingly, the Director under the Rule should play the same role as does the Commission.

The current collateral benefit rule should not be considered to be different than the collateral benefit rule in the Act just because a going private type transaction involves a shareholder vote. We do not agree with the view that, given the existence of a voting mechanism in a going private type transaction, it should follow that any collateral agreement must result in the involved shareholder being excluded from the vote (without regard to whether the collateral agreement is a collateral benefit). To take the view to its logical end, it suggests that the Commission is only willing to consider the collateral agreement/collateral benefit issue for take-over bids because the consequences of determining a collateral agreement to be a collateral benefit in the context of a take-over bid would be to prevent the bid from proceeding, which result could be commercially untenable. However, this view ignores the bottom line which is that the Commission has in the past, and presumably will in the future, prohibit a take-over bid from proceeding if the Commission determines a collateral agreement to be a collateral benefit, no matter the

consequences on a commercial level and no matter how small the recipient's shareholding is. In fact, it is in precisely this type of circumstance (i.e., a take-over bid with a collateral benefit) that parties can instead restructure as a going private type transaction on the theory that the structure allows collateral benefits provided there is a disinterested shareholder vote.

The existence of a voting mechanism in a going private type transaction, and the existence of the disinterested minority to vote, make it feasible for a shareholder to receive a collateral benefit and to still allow the transaction to proceed, provided there is a sufficient disinterested shareholder vote. Conversely, if it is determined that a going private type transaction does not involve a collateral benefit, the shareholder who is a party to the collateral agreement should not be disenfranchised just because the transaction is in the form of a going private type transaction.

The current collateral benefit rule should not be considered to be different than the collateral benefit rule in the Act just because the shareholders can in effect be squeezed out under a going private type transaction. The Commission recognized, when it approved the Rule, that the concern with going private transactions was not expropriation but rather related party conflicts of interest. In other words, it recognized that corporate transactions that resulted in public shareholders being cashed out or receiving shares of another issuer should only be regulated under the Rule to the extent there exists related party conflicts that result in one of the shareholders, as shareholder, being involved in a collateral agreement that is determined to be a collateral benefit. A shareholder should only be disenfranchised from his or her vote to the extent he or she is being treated differently in his or her capacity as a shareholder than the other shareholders. It is still, and should remain, incumbent on the Director under the Rule to make the determination as to whether a collateral agreement is a collateral benefit, and therefore whether or not the shareholder is receiving additional share consideration.

In any event, shareholders can in effect be squeezed out in certain circumstances under the take-over bid regime. For example, a 90% shareholder could enter into a collateral agreement with an arm's length bidder. Assuming the Commission determines the collateral agreement is not a collateral benefit under the Act, the shareholder could tender his or her shares and the bidder could then use the squeeze out provisions of the applicable corporate statute to squeeze out the remaining shareholders. Or, for example, a 40% shareholder could enter into such a collateral agreement and tender his or her shares which, together with shareholders owning 50% of the shares, brings the totalled tendered shares to 90%, again allowing the applicable corporate squeeze out provisions to be used. The variations can be many. The fact that a take-over bid could result in all shareholders being squeezed out does not prevent the Commission from determining that a collateral agreement is not a collateral benefit. The Director should be able to determine the same in connection with going private type transactions regardless of the squeeze out consequences.

Implied in the proposed collateral benefit rule is the view that shareholders who have a higher shareholding percentage in the target issuer are more likely to be persuaded by an offeror to tender their shares to a take-over bid or vote in favour of a transaction if offered a collateral benefit; and that their tender or vote would have a greater impact on the outcome of the transaction; therefore, it is only collateral benefits coupled with large shareholdings that should be monitored. This analysis seems flawed. The collateral benefit rule in the Act and the current

collateral benefit rule are there to ensure that all shareholders are treated the same and that no one shareholder, regardless of its ownership interest, receives a collateral benefit.

Something is or is not a collateral benefit. A shareholder qua shareholder either does or does not receive more consideration than the general body of shareholders. Where the consideration is the same, the percentage shareholding should not disqualify the shareholder in question from voting. The premise behind the Rule (as under the Act) is aimed at addressing situations of potential conflicts of interest. It is not, in our view, meant to address influence absent conflict. If this were the case, all transactions involving significant shareholders would be either prohibited or exclude such shareholders from the vote. In addition, given Canada's distinctive corporate landscape with its concentration of ownership, it seems both unfair and counter-intuitive to prevent such a shareholder from participating in a vote where his or her interest is not only aligned with shareholders generally but, in fact, may have been instrumental in obtaining the best possible terms under the transaction.

While it is perhaps laudable to try and create certainty in a rule, the proposed collateral benefit rule introduces new concepts which will in our view create more uncertainty in their application than is currently the case under the current collateral benefit rule. For instance, the terms "the conferring of the benefit is reasonably consistent with customary industry practices" and "the conferring of the benefit is not conditional on the related party supporting the transaction in any manner" will both no doubt raise their own interpretational issues and ultimately result in inconsistent applications in practice and/or calls to the Director for clarification by way of exemptive relief.

More importantly, the proposed collateral benefit rule would make going private type transactions more difficult to achieve on a commercial level and unjustifiably so on a cost/benefit analysis, assuming we all agree that acquisition transactions contribute to efficient capital markets. For example, the proposed collateral benefit rule would disqualify from the minority vote the shares of a chief executive officer who holds more than 10% of the outstanding shares and who had years prior negotiated a golden parachute in the event of a change of control. The examples could be varied. The result would be to potentially discourage take-over bids because (unless the 90% squeeze out provisions are guaranteed to be available) the second step going private type transaction, required to complete the change of control, would be governed by a different set of rules from the take-over bid rules, in that the second step transaction would not recognize, as part of the minority vote, those shares tendered to the first step take-over bid by, for example, the chief executive officer even though the Commission had determined, in the context of the first step take-over bid, that he or she had not received a collateral benefit.

The difficulty that the proposed collateral benefit rule presents from a commercial perspective, as discussed above, is increased by a couple of additional factors. First, the 10% threshold is determined based on an aggregation of all related parties who enter into collateral agreements. As a consequence, in an arm's length transaction where, for example, the chief executive officer and the chief financial officer each own five per cent of the shares of the issuer and each has a pre-existing employment agreement (with severance arrangements), their shares will be excluded from a minority vote. This in effect lowers the 10% threshold. Second, a valuation is not required for a transaction that is otherwise arm's length except for the collateral agreement, but is

required for a transaction that is already, for other reasons, caught within the Rule. Valuations are expensive and time consuming. It is unclear what they add in the context of employment relationships. And finally, there does not seem to be a rationale for requiring a valuation in one circumstance and not the other.

Conclusion

We believe the costs involved under the proposed collateral benefit rule, including the uncertainty from interpretational issues and the undue constraints on commercial initiatives, outweigh the alleged benefits. Rather, to the extent a collateral agreement is not a collateral benefit, disclosure of the agreement should suffice.

We recognize that the Commission (or Director) has a difficult role in having to determine whether a collateral agreement is a collateral benefit. Nevertheless, the Commission has recognized that it has a necessary role for take-over bids and we submit that it is no less necessary or applicable for going private type transactions.

Paragraph 104(2)(a) of the Act specifically delineates the test to be applied to determine whether or not a collateral benefit exists in connection with a take-over bid. We believe that the absence of such an explicit test under section 9.1 of the Rule for going private transactions should not be construed as implying that the test is not available. In fact, a historical analysis of the underpinnings of collateral benefits and going private transactions suggests the contrary. Section 9.1 of the Rule provides the Director with the discretion to make the necessary determinations, and the power should be used as the circumstances dictate.

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We would be pleased to discuss any aspect of this submission with you.

Yours truly,

OGILVY RENAULT

"*Cathy Singer*"