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July 14, 2003

DELIVERED

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

Attention: John Stevenson, Secretary

Dear Sirs:

Re: Request for Comments:
Proposed Amendments to OSC Rule 61-501 and Companion Policy 61-501CP
Insider Bids, Issuer Bids, Going Private Transactions and Related Party Transactions

This is our firm's response to your request for comments dated February 28, 2003, regarding the proposed amendments (the "Proposed Amendments") to OSC Rule 61-501 (the "Rule") and Companion Policy 61-501CP: *Insider Bids, Issuer Bids, Going Private Transactions and Related Party Transactions*. We have set out below:

(i) our comments about the general approach to the regulation of "business combinations"; and

(ii) specific drafting suggestions (which are also listed in the appendix for your convenience).

General Approach to Business Combinations

Under the current Rule, a transaction is subject to the going private transaction rules only if the transaction is "with or involving…a related party". The term "involving" lacks precision, but in our view it requires involvement that goes to the heart of the proposed business combination (such as where the related party receives different consideration for its securities or, in effect, acquires the business of the issuer), and not merely *any* involvement. A transaction does not involve a related party merely because an officer or director of the issuer receives an improved (but industry-standard) compensation package as part of the transaction or because a

related party enters into a non-material service contract with the issuer at the time of the transaction. There is a list of expressly excluded transactions (in paragraphs (a) through (e) of the current definition of "going private transaction") which is relevant in interpreting the meaning of "involving", but suffice it to say that the current threshold requirement that the transaction be "with or involving…a related party" lessens the importance of having a list of expressly excluded transactions that is perfect in clarity and scope.

The opposite is true under the Proposed Amendments, which define "business combination" extremely broadly without regard to involvement by a related party. Under this new definition, almost all transactions will be business combinations whether or not a related party is involved, unless the transaction falls into one of the exceptions in paragraphs (a) through (d). This means that the clarity and scope of these exceptions is absolutely critical. On the question of clarity, we think the use of double and triple negatives makes the section extremely difficult to interpret. On the question of scope, we think that some of the provisions will result in the rules being applied too broadly.

Overall, therefore, we think the definition of business combination should be simplified and the scope of the related rules should be clarified and narrowed, as discussed below.

Simplification

Simplification could be achieved by looking to the purpose of the amendments, which appears to be:

(i) to require a formal valuation for a business combination where a related party will control an issuer or substantially all of its business after giving effect to the combination, or where the business combination involves a connected transaction that is itself a related party transaction requiring a formal valuation; and

(ii) to require approval of a business combination by a majority of the disinterested minority in the same circumstances where a valuation would be required ***as well as*** in circumstances where related parties are receiving different consideration for their securities or are obtaining a "collateral benefit".

If this is correct, we suggest simplifying the definition of "business combination" and revising the provisions regarding minority approval by following the approach taken for the formal valuation requirement. The Proposed Amendments contain a section (4.3) that sets out the specific circumstances where a formal valuation will be required. We believe the same approach should be used for the minority approval requirement. This would permit deletion of all references to related parties in the definition of business combination (that is, paragraph (d) of the definition could be deleted in its entirety).

Under this approach, section 4.5 would be revised to state that an issuer is required to obtain minority approval of a business combination in circumstances similar to those described in section 4.3(1) (where a formal valuation is required) and in circumstances where a related party is entitled to receive, directly or indirectly, as a consequence of the transaction, different

consideration per security or a collateral benefit (in other words, in the circumstances now described in sub-clauses (d)(iii) (A), (B), and (D) of the definition of business combination).[1,2]

Clarifying and Narrowing the Scope

Equity Securities and Options

We have not included in the above list of circumstances where a collateral benefit will result in a minority approval requirement, circumstances where a related party merely receives consideration for securities that are not equity securities or options (sub-clause (d)(iii)(C) of the definition). It does not seem warranted to impose a minority vote requirement in every circumstance where this occurs, regardless of whether the related party receives a benefit and even in situations where the consideration is the same on a per security basis as others receive. If the Commission is concerned that the related party may hold securities different from those publicly held, presumably the receipt of unusual consideration for those securities will be caught as a collateral benefit (subject to the materiality threshold we discuss below). However, circumstances where the related party does not receive a "benefit" should not be subject to a minority approval requirement (where, for example, debt is repaid for its face amount plus accrued interest and there is no solvency concern regarding the issuer).

"Acquiring" or "Combining" With the Issuer

The Proposed Amendments require a formal valuation and minority approval if an interested party would, as a consequence of the transaction, directly or indirectly "*acquire the issuer or the business of the issuer*, or *combine* with the issuer, through an amalgamation, arrangement or otherwise, whether alone or with joint actors" (italics added). Because the italicized concepts do not have well-understood legal meanings, we are concerned that there could be substantial uncertainty in their application. As an alternative, we propose that a formal valuation and minority approval be required where an interested party will have *control* of the issuer after giving effect to the transaction (whether or not the interested party had control of the issuer before the transaction) or will acquire *all or substantially all* of the assets of the issuer after giving effect to the transaction. These concepts do have well-understood legal meanings and, we believe, they capture the circumstances intended by paragraph 4.3(1)(a) and clause (d)(i) of the definition of "business combination".

"Connected Transactions"

We find the treatment of "connected transactions" under the Proposed Amendments confusing. A "connected transaction" is defined to include *any* transaction that is negotiated or completed at approximately the same time as, or that is conditional upon the completion of, the main transaction (excluding transactions relating solely to employment, which are dealt with in the

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[1] We also suggest that both section 4.3 and section 4.5, as we propose it be revised, refer to a "related party" (rather than an "interested party") to avoid circularity in the use of the latter term.

[2] The definition of "interested party" would have to be revised to reflect the changes we are suggesting here and elsewhere in this response. We have reflected those changes in the appendix for your convenience.

definition of "collateral benefit"). Minority approval *of the business combination* will be required if a related party is a party to any connected transaction to the transaction, regardless of the effect or materiality of the connected transaction. However, a formal valuation will be required of the affected securities in the business combination only if there is a connected transaction that exceeds the related party transaction materiality threshold. We also note that section 5.1(e) excludes a business combination, but not connected transactions, from the related party transaction rules, indicating that the connected transactions will remain subject to the rules for related party transactions as well.

We agree that a broad view should be taken of the transaction as a whole, and the impact of transactions that are related to the main transaction should be considered to assess potential conflicts. We believe, however, that connected transactions should be taken into account as part of the business combination in determining whether a related party is being treated in a way that requires these additional regulatory protections, rather than prompting a minority approval requirement regardless of their impact. This can be accomplished by stating that connected transactions are to be treated as part of the business combination for purposes of determining whether the requirements for a formal valuation or minority approval have been triggered. The Rule already takes this approach in section 2.9(2) of the draft Companion Policy, where *a series* of two or more interrelated steps *is* the transaction for purposes of the definition of business combination.

All connected transactions should then also be considered on a stand-alone basis to determine whether, taken together, they are sufficiently material to independently require a formal valuation or minority approval. In that case, their materiality should be measured in the same way as under the existing rules regarding related party transactions (that is, the 25% of market capitalization test) and a formal valuation and minority approval should be required of the business combination and, separately, of the connected transactions.

We believe this should be stated explicitly and that the provisions should be clarified to ensure that the size of the connected transaction is measured, for the purpose of determining materiality, on a stand-alone basis separate from the business combination as a whole (albeit together with any other connected transactions). Therefore, we suggest the following two changes:

(i) connected transactions that form part of a business combination (as well as the entire business combination) should expressly be subject to the related party transaction rules, through an appropriate amendment to the exclusion section 5.1(e), such as the following:

> "the transaction is a business combination for the issuer, but for greater certainty any related party transaction which is a connected transaction to that business combination shall remain subject to this Part unless otherwise provided in this Part";

and

(ii) the requirement for a formal valuation in section 4.3(1)(b) (and the comparable provision we suggest for requiring minority approval in section 4.5) could be revised as follows:

> "(b) an interested party is a party to any connected transaction to the business combination, if the connected transaction is a related party transaction for which the issuer is required to obtain **[a formal valuation under section 5.4/minority approval under section 5.6]**, considering the connected transaction, for purposes of section 5.5(2), separately from the business combination."

"Collateral Benefits"

Under the Proposed Amendments, minority approval will be required if a related party is entitled to receive a collateral benefit. We are concerned that the definition of "collateral benefit" is too broad and will result in an unwarranted change to the Rule. We have therefore suggested changes to introduce a general materiality threshold, to exclude employment-related benefits that are consistent with industry standards, and to clarify who will be excluded from voting on the minority approval.

The definition of collateral benefit in the Proposed Amendments captures all benefits received by related parties, regardless of materiality, excluding only consideration that a related party receives for its equity securities that is the same on a per security basis as that received generally, and employment benefits if they meet specific requirements. In our view, there should be a materiality threshold before the presence of any non-employment benefit triggers the requirements for a minority vote. As well, we agree that employment benefits to related parties should be subject to special scrutiny, but we think the Proposed Amendments should not require minority approval where the benefits are consistent with customary industry practice.

As discussed above, under the current Rule, a merger negotiated at arm's length would not, in our view, trigger the requirements relating to going private transactions merely because one or more directors or officers of the issuer are entitled to receive improvements in their compensation package, as long as those improvements are consistent with customary industry practices. It would not be unusual for individuals in those positions to receive increases in their salaries and other benefits as part of a merger (to reflect the more substantial business and their increased responsibilities and risks). Under the Proposed Amendments, however, if that group holds more than 10% of the shares, the members of the group will be disenfranchised from voting on the transaction even if the benefits are consistent with customary industry practices, and are not material (such as a minor change in a group benefit plan or minor increase in salary). We do not believe that should be the case merely because the group holds more than 10% of the shares, provided the compensation arrangements are in accordance with customary industry practice.

We also suggest that the concept of "joint actor" be clarified in this context. If minority approval is required only because an interested party is receiving a collateral benefit, we would not have thought that an independent third party acquiring control of the company as part of

the business combination would be a "joint actor" with that interested party. We think it would be helpful to clarify this in the definition of joint actor by adding the following words at the end:

> "and an offeror making a formal bid, or a person or company involved in a business combination or related party transaction, is not considered a joint actor with an interested party or a related party of an interested party solely because that interested party or related party of the interested party will be obtaining a collateral benefit in conjunction with that transaction."

* * *

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

Yours sincerely,

Sharon Geraghty

SG/ko
Encl: Diskette with copy of letter and appendix

APPENDIX
to letter dated July 14, 2003 from Torys LLP

List of Proposed Changes

Definition of "business combination"

- Delete paragraph (d) of the definition in its entirety

- Add to the end of the definition the following statement:

> "and for purposes of determining whether a formal valuation is required under section 4.3 or minority approval is required under section 4.5, all connected transactions are treated as part of the business combination"

Definition of "collateral benefit"

- Delete clause (c)(iii) of the definition

- Add to the end of the definition a new paragraph (d) as follows:

> "(d) benefits, not described in paragraph (a), (b) or (c), which are not, in aggregate, material to the related parties receiving those benefits, as determined by the issuer's board acting in good faith."

Definition of "joint actor"

- Add to the end of the definition the following:

> "and an offeror making a formal bid, or a person or company involved in a business combination or related party transaction, is not considered a joint actor with an interested party or a related party of an interested party solely because that interested party or related party of the interested party will be obtaining a collateral benefit in conjunction with that transaction."

Definition of "interested party"

- Replace paragraph (c) of the definition with the following:

> "(c) for a business combination, a related party of the issuer at the time the transaction is agreed to, if the related party
>
> (i) would, after giving effect to the transaction, directly or indirectly control the issuer or would, as a consequence of

the transaction, directly or indirectly acquire all or substantially all of the assets of the issuer, whether alone or with joint actors;

(ii) is a party to any connected transaction to the business combination, if the connected transaction is a related party transaction for which the issuer is required to obtain minority approval under section 5.6, considering the connected transaction, for purposes of section 5.5(2), separately from the business combination; or

(iii) is entitled to receive, directly or indirectly, as a consequence of the transaction

(A) consideration per security that is not identical in amount and form to the entitlement of the general body of holders in Canada of affected securities of the same class,

(B) a collateral benefit, or

(C) consideration for securities of a class of equity securities of the issuer if the issuer has more than one outstanding class of equity securities, unless that consideration is not greater than the entitlement of the general body of holders in Canada of every other class of equity securities of the issuer in relation to the voting and financial participating interests in the issuer represented by the respective securities."

Formal Valuation Requirement: Section 4.3(1)

- Replace sub-section 4.3(1) with the following:

"(a) a related party would, after giving effect to the transaction, directly or indirectly control the issuer or would, as a consequence of the transaction, directly or indirectly acquire all or substantially all of the assets of the issuer, whether alone or with joint actors, or

(b) a related party is a party to any connected transaction to the business combination, if the connected transaction is a related party transaction for which the issuer is required to obtain a formal valuation under section 5.4, considering the connected transaction, for purposes of section 5.5(2), separately from the business combination."

Minority Approval Requirement: Section 4.5

- Replace section 4.5 with the following:

> "Subject to section 4.6, an issuer carrying out a business combination shall obtain minority approval for the business combination under Part 8 if:
>
> (a) a related party would, after giving effect to the transaction, directly or indirectly control the issuer or would, as a consequence of the transaction, directly or indirectly acquire all or substantially all of the assets of the issuer, whether alone or with joint actors,
>
> (b) a related party is a party to any connected transaction to the business combination, if the connected transaction is a related party transaction for which the issuer is required to obtain minority approval under section 5.6, considering the connected transaction, for purposes of section 5.5(2), separately from the business combination, or
>
> (c) a related party is entitled to receive, directly or indirectly, as a consequence of the transaction
>
> (i) consideration per security that is not identical in amount and form to the entitlement of the general body of holders in Canada of affected securities of the same class,
>
> (ii) a collateral benefit, or
>
> (iii) consideration for securities of a class of equity securities of the issuer if the issuer has more than one outstanding class of equity securities, unless that consideration is not greater than the entitlement of the general body of holders in Canada of every other class of equity securities of the issuer in relation to the voting and financial participating interests in the issuer represented by the respective securities."

Expressly Include Connected Transactions in Related Party Transaction rules: Section 5.1(e)

- Replace paragraph 5.1 (e) with the following:

> "(e) the transaction is a business combination for the issuer, but for greater certainty any related party transaction which is a connected transaction to that business combination shall

remain subject to this Part unless otherwise provided in this Part";