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BY TELECOPIER February 4, 2004

Ontario Securities Commission
20 Queen Street West
Suite 1800
Toronto, Ontario M5H 3S8

Attention: Mr. John Stevenson, Secretary

Dear Mr. Stevenson:

Re: Adoption of Proposed Amendments to OSC Rule 61-501

This letter represents my personal and without prejudice comments (and not those of the firm or any client) with respect to the OSC's adoption of proposed amendments to OSC Rule 61-501.

Collateral Benefits

1. The proposed definition of "collateral benefit" is in my view conceptually seriously flawed. The OSC indicates that pre-existing rights, such as contractual rights, and rights represented by arrangements such as loans, leases, purchase agreements, and employment and director related compensation arrangements, etc., will all now be found to be collateral benefits. Secondly, the OSC proposes to disregard offsetting costs. In doing this, the OSC is ignoring both economic reality and its past decisions. See, for example, *Noverco*, where a shareholders agreement containing mutual rights of first refusal, etc. was seen to be normal, and a put and call arrangement was seen to be perfectly "counter-balanced". The existing concept, as will still exist for take-over bids under OSA s. 97(2), requires that a collateral benefit have the "effect…of providing greater value". With the exception of employment arrangements, where OSC staff has previously suggested (although many practitioners disagree, absent some "value" effect) that normal commercial employment arrangements should be seen as collateral benefits that require exemptive relief, there has been in my mind no evidence of

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any abuse that calls for an approach that ignores business and economic reality by pretending that benefits are cost-less. While, in part in response to past comments, two types of exemptions have been added for de minimus and immaterial collateral benefits, they seem insufficient to handle many common situations. In addition, in one of the exemptions offsetting costs are taken into account, which seems inconsistent with the general approach.

2. For example, consider a mid-sized widely-held Canadian public company being acquired in a merger by an arm's length purchaser for $100 million in aggregate, and assume that the CEO and the CFO each own 2% of the company, for a total management interest of 4%. Each is paid $250,000 per year and has an employment agreement that entitles him to 2 years and 18 months termination pay following a change of control. The CEO's $500,000 golden parachute, and the CFO's $375,000 golden parachute, would each be more than 5% (i.e. more than $100,000) of the $2 million they will receive for their stock. Thus, the transaction will become a business combination subject to minority approval requirements and enhanced disclosure, as well as a possible mandatory independent committee, and thus the associated increased costs. Even absent an employment agreement, as long-serving employees, they would likely be entitled to approximately 12 months severance at common law, which would also be numerically offside.

3. Take a second example, where the CEO has loaned the target company $250,000 at prime on a demand basis, or owns $250,000 in publicly traded preferred shares of the target with a market yield and that will be redeemed at their pre-established redemption price at closing. The common equity is clearly worth $100 million, so there should be no concern about the loan's recoverability or the value of the preferred shares. Yet the repayment of this loan at the closing of the merger, or the redemption of these preferred shares, would again result in the transaction being a business combination, even though there is in fact no real economic benefit at all.

4. An additional concern is that by deeming a director or officer not to be able to vote with the minority, in addition to potentially disenfranchising him or her as a shareholder even in the absence of any real value, his or her ability to vote as a director or act as a committee member may be seen to be affected as well.

5. Similarly, usual treatments of warrants or stock options could have a similar result.

6. These examples are designed to demonstrate that pre-existing legal obligations and practices (e.g. continued D&O insurance) should not constitute collateral benefits, that offsetting costs need to be taken into account, and that the exemption thresholds should be raised. If need be, I might suggest requiring the

board (or independent directors) to come to the conclusion that the benefits, net of offsetting costs, are not material in the circumstances.

7. In any event, often a growth-oriented small or mid-sized company underpays its senior management on the theory that it should keep costs down and they will benefit via their equity stakes. When acquired by a larger company, its senior management employees will either leave or will be offered employment with the larger enterprise in accordance with its customary pay and benefit scales to ensure fairness among employees. Similarly, target board members who may join the buyer's board will likely benefit from substantially higher compensation and D&O insurance, and those leaving will likely benefit from run-off D&O insurance. There should therefore be a complete exemption regarding directors, officers or employees where they will be compensated or receive benefits in accordance with the buyer's practices or for run-off D&O insurance (as well as an exemption where the benefits are in accordance with pre-existing obligations or practices).

Other

8. As I understand that the TSX is removing the possibility of stock exchange take-over bids from its rules, perhaps references thereto should be removed. See, for example, the definition of "disclosure document".

9. In section 1.5, I suggest adding "(rather than such securities)" after "cash proceeds of the redemption", to clarify that it is only the cash that need to be considered in these circumstances.

10. In para. (a) of the definition of "business combination", as the rule will now expressly cover income trusts, and given their rise, I suggest adding "or a non-statutory right that is similar to the statutory rights contained in the OBCA". Most income trusts provide for similar rights in their trust indentures, rather than by statute (since they are creatures of contract and trust law, not statute). This is similar in concept to s. 5.7(1)(8)(b).

11. It is not clear what s. 5.7(1)(3)(b) means, given that the consideration is cash (this is a securities for cash transaction), or how s. 5.7(2) can be applied given that the (b) exemption only applies to a cash issuance.

12. The notice clarifies (on p. 561, comment 13) that a "party to the transaction" does not include a person whose "sole" connection with the transaction arises from the fact that his or her employment arrangements will be affected by it. The word "sole" is a little worrying; what if he or she is also a security holder, director or officer?

13. With respect to the OSC's comments regarding s. 5.5(4), it is suggested in the notice that the transactions would be "publicly announced before [they were]

carried out". If "carried out" means closed, I agree. However, if "carried out" means agreed to (as might be expected), normally an issuer would not want to publicly disclose a possible transaction until it had a binding agreement. Thus, I think it is essential that the proposed transaction itself be excluded from the undisclosed material information basket to make this exemption workable. See also s. 6.3(2)(d), which cross-references s. 5.5(4).

14. Including a material amendment to a debt, liability or credit facility with a related party in the definition of a related party transaction is concerning from at least three perspectives.

First, particularly in a default or troubled company scenario, a lender who is a related party may need to seek minority shareholder approval to amend a loan to involve equity or voting securities. This may well discourage credit and/or be unfair to lenders if parties without a real stake or legitimate economic interest get a veto right. I thus do not recommend this at all.

Second, query whether para. (f) of the definition of related party could capture a lender with substantial influence under a credit agreement in a troubled company situation. To avoid this possibility, the words "other than a bona fide lender" should be included, as in the definition of a "control block holder" (and is currently the case in the definition of related party generally).

Third, s. 5.7(3) provides that in valuing an amendment to a loan or credit facility (or a security for that matter), the whole transaction, and not just the amendment, would be valued, and that warrants would be given their maximum value based on current prices, even though they may have no current value. These provisions seem to ignore economic reality, and seem inappropriate.

15. The companion policy suggests that giving a security holder preferential treatment to obtain its support will "not normally be considered justifiable", and that "differential treatment is only justified if its benefits to the general body of security holders outweigh the principle of equal treatment". The policy indicates that while the OSC will "generally rely on an issuer's review and approval process", it may intervene "if it appears that differential treatment is not reasonably justified". The intention behind this provision is unclear, especially given the various "targeted issuer bid" transactions that have been approved from time to time, often with minority approval, by the OSC (e.g. *Power Corp.*, *BioChem Pharma*). Clarification may be appropriate. In particular, it is somewhat hard to weigh differential treatment (given after minority approval) against a "principle". Where minority approval is obtained, what is the Commission's concern?

16. The proposed rule defines the term "income trust" quite broadly as a "trust or other entity that issues securities that entitle the holders to net cash flows

generated by another entity". This may not extend to REITs owing their assets directly, as a result, but may well be too broad, and perhaps is better undefined after all. Furthermore, the rule would deem transactions and related parties of the underlying entity to be transactions and related parties of the income trust itself. However, note that in some cases income trusts do not have control of one or more underlying businesses, so this may not be appropriate in all cases. Is it necessary?

17. Should the various references to shareholders in Canada be shareholders in Ontario, given the fact that other provinces are generally not following this rule? Also, how will the rule be affected by the USL project?

18. Re s. 1.3, what if the wholly-owned subsidiary entity was a public company with preferred shares outstanding, and its parent was a non-reporting issuer. Would that provide an exemption on the basis of not being a reporting issuer?

19. Transitional provisions seem necessary to enable the completion of any transaction that was agreed to and proceeding under an exemption that will now be amended or repealed, to ensure that it can be completed without being subject to new and different requirements (much like current s. 4.1(2)(d) operated when Rule 61-501 was first introduced). Currently, this only applies to pre-May 2000 related party transactions (see s. 5.1(h)), but doesn't this need to be broadened substantially?

20. As NI 62-102 is to be repealed, shouldn't s. 4.4(2)(b) be amended?

21. Old s. 5.1(k) was designed to confirm that even if a related party bought convertible securities or similar instruments, the exercise of rights thereunder would not suddenly become a related party transaction. It seems useful to preserve this clause.

22. S. 8.1(2)(c) seems hard to apply to a person who is solely a director of the issuer. Should it be clarified that he or she can vote?

23. Finally, in publishing the final form, a black-line against the current version of the rule and policy would be very much appreciated.

Thank you for considering those comments.

Yours truly,

Simon Romano

SAR/he

cc.: Fernand Lavigne – QFMA
Ralph Shay - OSC