

Recent developments in the Canadian securities markets



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The Canadian securities industry continues to be faced with globalization and consolidation challenges. The recent resurgence of merger speculation between the TSX Group and the Montreal Exchange as well as the continuing debate regarding the creation of a single national regulator will no doubt keep things interesting in the markets for the remainder of the year. Three recent developments are of some significance: executive compensation disclosure, stand-still agreements in auctions, and the Securities Transfer Act.

Executive compensation disclosure

The Canadian Securities Administrators (CSA) are wrestling with new trends in executive compensation disclosure. On March 29 2007 the CSA published proposals (the March proposals) to replace the current requirements, which the regulators say have not kept pace with changing disclosure practices and result in fragmented compensation information.

The CSA hope that the new disclosure rules, when finalized, will improve “the quality and transparency of executive compensation disclosure.” The content of the ultimate proposals should not be a surprise to observers of compensation disclosure in the United States, but for many issuers in Canada, the changes will result in considerably more effort in preparing their executive compensation disclosure in the future.

On August 31 2007 the CSA pulled the March proposals for further review and will publish amended proposals for comment later this year. It will be interesting to see how the new proposals differ from the March proposals, the highlights of which are described below.

Summary compensation table

A new summary compensation table is designed to eliminate the perceived shortcomings in disclosure under the current requirements. For example the summary compensation table must include an additional column showing the total compensation. The objective of this proposal is clear: to reduce all elements of compensation to numbers, and to reflect all of them in tabular disclosure.

Compensation discussion and analysis

A new compensation discussion and analysis section is intended to allow for a comprehensible and comprehensive description of the issuer’s compensation policies and plans. This description must set out the objectives of the compensation program, what it is intended to reward, each element of the program, why each element is paid, how the amount of compensation was determined and how each element fits into the issuer’s overall compensation objectives.

Performance graph

A new performance graph is used to show how the trend in the total shareholder return of the issuer compares to the trend in compensation to the issuer’s executives.

Stand-still agreements in auctions

A public company often maximizes its selling price by using an auction process. In 2007, a decision of the Ontario Court of Appeal (*Sunrise REIT v Ventas*) had the dramatic effect of preventing an apparently higher offer in the context of an auction process from being made.

Background

In November 2006, the board of Sunrise Senior Living Real Estate Investment Trust (Sunrise) created an auction process. Negotiations proceeded with two interested parties

– Health Care Property Investors, Inc (HCP) and Ventas Inc (Ventas) who each entered into confidentiality agreements with Sunrise. Ventas’ agreement stated that the stand-still provision ceased to apply if, among other things, Sunrise entered into an agreement to sell more than 20% of its units or assets to a third party. HCP’s agreement contained no such provision. Ventas submitted a proposal to acquire Sunrise’s assets which was approved by the board.

In January 2007, Ventas and Sunrise entered into a purchase agreement which contained a covenant whereby Sunrise agreed to enforce any stand-still provisions and also contained a fiduciary-out provision that permitted the board to accept a superior unsolicited *bona fide* proposal. The agreement also contained a provision, not expressly subject to the fiduciary out, that required Sunrise to enforce the stand-still provisions in any third party confidentiality agreements. Despite the stand-still provision, HCP submitted a superior offer to Sunrise. As a result of this offer, Ventas told Sunrise to enforce the HCP’s stand-still provision.

The parties applied to court to determine whether Sunrise could entertain the HCP offer.

Decision

The Ontario Superior Court, in a decision upheld by the Ontario Court of Appeal, concluded that Sunrise was obligated to enforce the HCP stand-still, despite the superior HCP proposal. The court concluded that the fiduciary out did not override the covenant in the purchase agreement not to waive the stand-still provision in any confidentiality agreements. Ultimately, Ventas increased its offer and the Sunrise unit-holders approved the transaction.

Emerging issues

As a result of this case it is important to note that the stand-still provisions in confidentiality agreements must be drafted carefully. Other issues to consider include the following:

- Should confidentiality agreements now be drafted to include stand-still provisions that terminate when entered into by target companies and the top bidder of a purchase agreement? Some target companies may prefer that auction participants not have such termination rights in order to create an incentive for parties to put forward their best offer, because they know that any purchase agreement entered into with the successful bidder will prohibit the target from waiving any stand-still, preventing superior bids from being made later.
- If different parties have different stand-still agreements, the incentives for parties in the auction may be different, which may lead to a potentially unfair auction process. Accordingly, counsel to the target companies should try to ensure that all their confidentiality agreements contain identical stand-still provisions. Bidders should consider whether a most favoured nation clause should be employed in the confidentiality agreement.
- It is unclear whether this decision implies that target boards can contract out of their fiduciary duty, which would be contrary to analogous American *jurisprudence* in this area.

Securities Transfer Act

The Securities Transfer Act, 2006 (Ontario) (the STA) and related amendments to the Personal Property Security Act (Ontario) (the PPSA) came into force as of January 1 2007 and analogous statutes are now in force in other Canadian provinces. The new rules are intended to accommodate modern securities settlement systems where securities are held indirectly through intermediaries in centralized securities depositories and where computerized book-entries are relied upon for settlement.

The STA and the related amendments to the PPSA will have a significant impact on commercial practice and on the use of securities as collateral for loans, derivatives and other financings. Among other things, the new regime:

- Creates a new form of investment property called a securities entitlement to capture the bundle of property and contract rights related to the financial assets within a securities account held by an intermediary or broker;
- Establishes new priority rules for investment property;
- Uses the concept of control as the modern equivalent of possession of a negotiable certificate under existing law; and
- Sets out new conflict of laws rules in the PPSA.