

Corporate Securities Law

June 29, 2004

OSC Amends Rule on Insider Bids, Issuer Bids, Business Combinations and Related Party Transactions

Amendments to Ontario Securities Commission (“OSC”) Rule 61-501 (the “Rule”) and its companion policy (the “Companion Policy”) came into force on June 29, 2004. The substance of the Rule is to regulate issuers involved in insider bids, issuer bids, business combinations and related party transactions and to provide securityholders with the benefit of enhanced disclosure in these circumstances. The amendments to the Rule are designed to make the Rule clearer, easier to use and to reduce the necessity for applications for exemptive relief.

The following is an outline of the principal amendments to the Rule.

1. Business Combinations

References to “going private transaction” will be replaced with references to “business combination” in both the body and title of the Rule. The Rule defines “business combination” to mean an amalgamation, arrangement, consolidation, amendment to the terms of a class of equity securities or any other transaction as a consequence of which the interest of a holder of an equity security of an issuer may be terminated without the holder’s consent, regardless of whether the equity security is replaced with another security. The modified language will clarify the application of the Rule and resolve inconsistencies with corporate legislation resulting from the use of “going pri-

vate transaction” terminology. The amended Rule governs business combinations in which one or more related parties receive benefits unavailable to other equity securityholders even if the transaction is between arm’s length parties and even if the issuer is not “going private”.

2. Collateral Benefits

A definition of “collateral benefit” has been introduced to the Rule to minimize confusion as to the application of the concept. If a benefit falls under the definition of a collateral benefit, the votes of the recipient of the collateral benefit may not be included in the circumstances where minority approval is required.

Collateral benefits include benefits, with specified exemptions, received by related parties as a consequence of a transaction such as a business combination, whether those benefits arise from pre-existing arrangements with the issuer, such as golden parachutes, or are offered by the acquirer of the issuer.

The new definition provides for certain exceptions to accommodate employee-related benefits, such as participation in a group benefit plan for employees of the successor issuer. In the case of other benefits an exception is available if the value of the benefit, net of offsetting costs to the related party, is less than 5% of the value of the consideration that the recipient will receive in exchange for his or her equity securities or the related party owns less than 1% of the outstanding securities of each class of securities of the issuer.

3. Downstream Transactions

The amended Rule excludes downstream transactions in the definition of “business combination”. Downstream transactions are transactions between the issuer and an entity in which the issuer holds a control block, as long as another related party of the issuer does not also hold a significant position in that entity. While a downstream transaction is carried out among related parties, it does not give rise to the type of conflict of interest, from the standpoint of the party holding the control block, that the Rule was designed to address.

4. Lock-Up and Support Agreements

Under the Companion Policy, a lock-up or support agreement did not, in and of itself, constitute acting jointly or in concert with an acquirer in a business combination. The effect of this interpretation would be that the locked-up securityholder is not precluded from voting on the business combination. However, in a 2002 decision the British Columbia Court of Appeal decided that the Rule disqualified a locked-up securityholder from voting despite the Companion Policy as the Court of Appeal took the Rule literally. Under the amendments, the Companion Policy's interpretation has been moved to the Rule, which will eliminate the uncertainty created by the B.C. decision. A locked-up securityholder will not be precluded from voting on a business combination provided that the securityholder is not otherwise disqualified on the basis of collateral benefits.

5. Insider Bids

The definition of "insider bid" has been expanded to include a take-over bid where the offeror was an insider of the offeree issuer within 12 months preceding the bid. As before, an insider bid must be accompanied by a formal valuation of the target obtained by the target unless an exemption is available. The amended Rule adds a requirement that the independent committee of the target issuer's board of directors must use its best efforts to ensure that the formal valuation is completed and provided to the offeror in a timely manner. The change addresses concerns raised by bidders carrying out unfriendly insider bids.

6. Circumstances where Formal Valuation Required

The OSC recognizes that the expense of a formal valuation may outweigh the benefits in some cases. The amended Rule adds to the formal valuation exemptions for issuers in defined circumstances including the following:

- (a) A formal valuation will no longer be required for a transaction that meets the definition of business combination solely because a related party is receiving a collateral benefit, although the related party will be excluded from the minority approval vote. If a related party is a party to a substantial transaction, such as a sale of assets, that is connected to the business combination, a formal valuation for the business combination will be required.

- (b) Issuers that are not listed or quoted on the TSX or major U.S. markets will not be required to obtain valuations. This replaces the exemption for related party transactions smaller than \$500,000 and for certain types of transactions by issuers listed on the TSX Venture Exchange.
- (c) If the consideration to be received by securityholders under a insider bid, issuer bid or business combination is comprised of securities for which a liquid market exists, a formal valuation of those securities will only be required if they constitute more than 25% of the outstanding class, up from 10% in the old Rule.

7. Minority Approval Exemption for Certain Junior Company Financings

The amendments include a minority approval exemption for related party cash financing transactions of \$2.5 million or less for issuers not listed or quoted on the TSX or major U.S. markets. To qualify for this exemption, two-thirds of the issuer's independent, non-employee directors must approve the transaction.

8. Downward Adjustments in Formal Valuations

The current Rule provides that a formal valuation of securities must not include a downward adjustment to reflect the liquidity of the securities, the effect of the transaction on the securities or the fact that the securities do not form a part of a controlling interest. The amended Rule confines this provision to the valuation of securities being relinquished by public securityholders in an insider bid, issuer bid or business combination. The provision no longer applies to securities that the public holders are to receive in a securities exchange transaction.

9. Securityholders Excluded from Voting in a Minority Vote

The amended Rule will permit, in certain circumstances, some categories of related parties to participate in a minority vote where they were previously excluded. This amendment covers situations where the conflict of interest issue that the Rule addresses is not applicable or is not significant enough to justify disenfranchisement. For example, in the case of an issuer carrying out a major transaction with its parent company, the amended Rule will permit directors and senior officers of sister companies and subsidiaries of

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the issuer to vote if they are not otherwise connected to the parent company.

We invite you to contact any member of the Goodmans securities team to discuss the amendments to Rule 61-501 and how they may affect your company.

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