Fairness at What Price? An Analysis of the Regulation of Going-Private Transactions in OSC Policy 9.1

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Ensuring that minority shareholders receive fair treatment appears to have been the original motivation for the Ontario Securities Commission's efforts to regulate going-private transactions. In light of recent proposed revisions to Policy 9.1, it is important to revisit the question of what, exactly, is meant by "fairness" in the context of going-private transactions. The author favours a conception of fairness that is directly related to the price that minority shareholders ultimately receive on a going-private transaction.

The author argues that two of the obligations imposed on corporations by Policy 9.1 in its current form, namely disclosure of information and majority of the minority voting, further the objective of price-based fairness to minority shareholders. It is highly questionable, however, whether independent valuation and the formation of independent committees to select a valuer promote price-based fairness. If it is accepted that Canadian markets are not strong-form efficient, then disclosure of any information which would lead shareholders to demand a higher price for their shares would guard against unfairness by preventing the exploitation of non-public information by majority shareholders. Since access to such information would be meaningless without an accompanying power to reject an unfair share price, the majority of the minority approval requirement of Policy 9.1 is similarly justified.

By contrast, assessments of minority share value done by independent valuers as well as the establishment of independent committees to oversee the valuation process are more problematic. Social acquaintances between valuers, members of the independent committee and management make the independence of valuers questionable. Moreover, determining the true value of a share can be a difficult, if not impossible, task.

The author concludes that in the absence of empirical evidence, it is difficult to assess whether regulation is effective or necessary.

La réglementation de la Commission des valeurs mobilières de l'Ontario régissant les transformations en compagnies privées semble avoir été adoptée avec comme objectif d'atteindre une certaine équité pour les actionnaires minoritaires. À la lumière des révisions proposées de la *Policy 9.1*, il importe de voir en quoi consiste exactement le concept d'équité dans le contexte des transformations en compagnies privées. L'auteure préconise une définition directement liée au prix payé aux actionnaires minoritaires pour leurs actions au terme d'une transformation en compagnie privée.

L'auteure est d'avis que seulement deux des quatre obligations imposées aux compagnies par la *Policy 9.1* dans sa forme actuelle, soit le dévoilement d'information et l'accord de la majorité de la minorité des actionnaires, nous rapprochent de l'objectif d'équité basée sur le prix. Il est cependant douteux que les exigences quant à l'évaluation indépendante de la valeur des actions et la mise sur pied de comités indépendants pour la supervision de cette évaluation assurent l'équité telle qu'envisagée par l'auteure. Ainsi, s'il est accepté que le marché canadien n'est pas un marché où l'information circule parfaitement, l'obligation de dévoiler des informations pouvant inciter les actionnaires à demander un prix plus élevé pour leurs actions préviendrait l'exploitation par les actionnaires majoritaires d'information non-disponible au public. Puisque la détention de cette information est inutile si elle n'est pas accompagnée du pouvoir de rejeter l'offre d'un prix injuste aux actionnaires minoritaires, l'exigence de l'accord de la majorité de la minorité est justifiée.

Cependant, il s'avère que l'évaluation des actions minoritaires par des évaluateurs indépendants, tout comme la supervision de l'évaluation par un comité indépendant posent problème. Les relations sociales des évaluateurs, des membres des comités indépendants et de la gestion mettent en cause l'indépendance des évaluateurs. De plus, la détermination de la valeur réelle des actions peut être une tâche difficile sinon impossible.

L'auteure conclut qu'en l'absence de telles études, il est difficile d'évaluer l'efficacité et le bien-fondé de la réglementation.

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Introduction

Over the past two decades, going-private transactions ("GPTs") have become increasingly regulated in Canada.[1] While provincial securities regulators refrain from prohibiting GPTs, they are concerned that GPTs can be unfair to minority shareholders. As a result of this concern, regulators have set up an armoury of rules with which a corporation must comply if it intends to complete a GPT. Under Ontario Securities Commission Policy 9.1 ("Policy 9.1"), a corporation must obtain a valuation, receive minority approval at a shareholders' meeting and comply with stringent disclosure requirements before proceeding with a GPT. In addition, Policy 9.1 states that it is "good practice" for a corporation to establish a special committee of independent directors prior to proceeding with a GPT. In addressing recent claims by minority shareholders that they had been treated unfairly, the Ontario Securities Commission ("OSC") indicated that it may develop even more stringent rules to govern GPTs.[2]

Policy 9.1 defines a GPT as a transaction in which the interest of a holder of a participating security in a target company may be terminated without his or her consent and without the substitution of an equivalent value in a participating security of the acquiror.[3] A typical GPT is structured as a one-step amalgamation transaction in which the acquiror incorporates a wholly-owned subsidiary and transfers its majority shareholdings to the subsidiary. The subsidiary then amalgamates with the target. The common shares of the subsidiary, which are the shares held by the acquiror, are converted into common shares of the amalgamated entity. The common shares of the target, being the shares held by the minority shareholders of the target, are then converted into redeemable preference shares of the amalgamated entity.[4] The shares held by the target in the subsidiary are cancelled. The amalgamation occurs with shareholder approval and the preference shares are redeemed for cash.

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[1] Ontario Securities Commission, "Disclosure, Valuation, Review and Approval Requirements and Recommendations for Insider Bids, Issuer Bids, Going Private Transactions and Related Party Transactions" in P.G. Findlay, ed., *Consolidated Ontario Securities Act and Regulation 1996*, 25th ed. (Toronto: Carswell, 1996) at 1115 [hereinafter Policy 9.1].

[2] See A. Willis, "Gordon finds fault with valuation of Ford Canada" *The Globe and Mail* (30 September 1995) B2; B. Critchley, "Break-up Fees to Outlast Tangled Deal" *The Financial Post* (24 October 1995) 5.

[3] Policy 9.1, *supra* note 1, s. 2.2(4). The OSC recently issued "Notice of a Proposed Rule and Policy Under the Securities Act (Ontario) — Insider Bids, Issuer Bids, Going Private Transactions and Related Party Transactions" (1996) 19 O.S.C.B. 2981 [hereinafter Proposed Revised Rules] in which it proposes a new type of GPT which it terms a "quasi-going private transaction." This type of transaction involves a person or company that is a related party of the target and would be a GPT if it were not for the substitution of an interest of equivalent value in a participating security of the target. See Part II "Evolution of the Fairness Principle and the Regulation of GPTs" below for a discussion of the Proposed Revised Rules.

[4] In some cases, the shares held by minority shareholders may be exchanged for shares in the acquiror. In such cases, the transaction would not fall within the definition of "going private transaction" under Policy 9.1, but would be considered a "quasi-going private transaction" under the Proposed Revised Rules, *ibid.*

GPTs may also occur as a second step after a takeover bid for the target. If a certain percentage of the target's shares — ninety percent under the federal corporate statute[5] — are acquired under the bid, the balance of the shares can be compulsorily acquired and there is no need for a second step. Typically, however, the bid also discloses the acquiror's intention to effect a second-step GPT so that the shares tendered to the bid can be counted for the purposes of minority approval requirements.[6] Assuming other conditions in Policy 9.1 are met, the second step can be effected after the bid.[7]

Because minority shareholders are forced to sell their shares in a GPT, a central issue with respect to the regulation of these transactions is how to ensure that the minority shareholders receive a fair price for their shares. Two competing principles dominate the debate: the efficiency principle and the fairness principle. The efficiency principle asserts that market price is an accurate measure of the value of a corporation's shares.[8] According to this principle, there is no need to look beyond market price to measure value. Competition among investors and other market participants "ferrets out" all relevant information with respect to the value of a share. This information is reflected in the share price and, therefore, regulation is unnecessary to ensure that shareholders receive a fair price.

The fairness principle does not recognize the market's ability to reflect appropriate share prices in the context of a GPT. Proponents of this principle maintain that relevant information, particularly non-public or inside information, is not reflected in market price. In particular, market price does not reflect the benefits to be gained through taking a corporation private, such as reduced agency costs and the saving of public company costs.[9] Those who espouse the fairness principle seek to ensure that the controlling shareholder does not treat the minority shareholders unfairly by offering a price that is less than the value of the shares without also disclosing the information necessary to assess the offer. In the context of a GPT, therefore, regulation is necessary to ensure that minority shareholders receive a fair price for their shares.

Part One of this article examines the efficiency and fairness principles in greater detail and presents them as a theoretical structure within which regulation of GPTs may be analyzed. In Part Two, it is argued that Policy 9.1 is founded upon the fairness principle and that the efficiency principle has been implicitly discarded as a viable

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[5] *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, s. 206(2) [hereinafter CBCA].

[6] Policy 9.1 indicates that if the acquiror discloses its intention to effect a second-step GPT and provided that certain conditions are met, it can count the shares tendered under the bid for the purposes of minority approval requirements in completing the second step. See Policy 9.1, *supra* note 1, s. 32.1.

[7] See *ibid.* For an overview of rules relating to GPTs, see C.L. Saga & A.I. Anand, "Complex Rules Govern Going-Private Transactions" *The National Law Journal* (21 August 1995) B9.

[8] See V. Brudney, "Efficient Markets and Fair Values in Parent Subsidiary Mergers" (1978) 4 J. Corp. L. 63 at 64 [hereinafter "Efficient Markets"].

[9] Examples of public company costs include costs associated with listing, registering, preparing and filing documents and costs associated with servicing shareholders, including record keeping, hiring transfer agents and legal counsel.

means of assessing value. This conclusion is reached by outlining the history of regulation with respect to GPTs in Ontario which culminated with the implementation of Policy 9.1. It is further contended that the use of the term "fairness" in Policy 9.1 is ambiguous; it is unclear whether the measures adopted to achieve fairness and perceived fairness in Policy 9.1 actually achieve this end. A conception of fairness that is directly related to the price that minority shareholders receive on a GPT should be adopted. Once fairness is conceived in terms of price, there is no need to ensure that GPTs are *perceived* to be fair.

Part Three questions whether the regulation of GPTs in Policy 9.1 is necessary to ensure that minority shareholders receive a fair price. Based on the argument that capital markets in Canada are not strong-form efficient, two aspects of Policy 9.1 are necessary to protect minority interests: disclosure of information requirements and majority of the minority approval. The effectiveness of the rule requiring an independent valuation and the OSC's recommendation that the target establish a special committee of independent directors are questioned. Recent GPTs have indicated that the valuation is of little guidance to minority shareholders and that often, valuers and special committees are independent in name only.

This conclusion highlights the importance of using empirical evidence to support the implementation of regulation. The approach of the regulators has been to respond to practices that are perceived to be unfair by adding to existing regulation, as though the absence of such additional regulation would necessarily leave minority shareholders in a position where their interests were inadequately protected.[10] Policy 9.1 imposes significant costs on acquirors such as those associated with hiring an independent valuer, forming a special committee of independent directors, compiling and circulating an information circular, and holding a shareholders' meeting. Because the regulation of GPTs imposes such significant costs, securities regulators bear some responsibility to justify new regulation by providing tangible evidence that the regulation will fulfill its intended objectives and that the benefits received by minority shareholders will outweigh the costs imposed by the regulation.[11] Discharging this burden calls for cost-benefit analyses in which serious attention is paid to empirical data.

I. The Efficiency and Fairness Principles

A. The Efficiency Principle

According to the efficient-markets hypothesis[12] or the efficiency principle, regulation of GPTs is undesirable as it impedes operation of the capital markets which, if

[10] See R.J. Daniels & J.G. MacIntosh, "Capital Markets and the Law: The Peculiar Case of Canada" (Fall 1990) *Canadian Investment Review* 77.

[11] See N. Wolfson, "A Critique of Corporate Law" (1980) 34 U. Miami L. Rev. 960 at 981.

[12] For a discussion of the efficient-markets hypothesis as it pertains to GPTs, see "Efficient Markets", *supra* note 8.

permitted to operate freely, would enrich society as a whole.[13] There is no need to look beyond the market value of the shares to determine the price at which minority shareholders will be squeezed-out; a fair price can be determined by the market alone. In order for the market to determine a fair price, certain underlying assumptions must be made. One of these is the existence of a perfect market wherein there is a free flow of information, many participants, no institutional imperfections, and no corrupt or manipulative influences are present.[14] If these conditions exist, regulation of GPTs is unnecessary.

Market efficiency is defined in relation to the availability of information to investors.[15] Three types of market efficiency are distinguished: weak-form efficiency, semi-strong-form efficiency and strong-form efficiency. A market is efficient in the weak form if all historical price and trading data is reflected in the prices of securities. In this case, investors cannot expect to earn superior returns using trading strategies that are based solely on historical price and volume data. In the semi-strong form, a market is efficient if an investor cannot earn excess returns from trading rules that are based on publicly available information. A market is efficient in the strong form if an investor cannot earn a superior return using *any* information, whether such information is public or not.

If markets were strong-form efficient, there would be no need to regulate GPTs since the market price of the shares would include all relevant information, including inside information. As Brudney explains this theory, reliance on the market as the measure of value is fair because, "the market ferrets out all relevant information about the prospects of an enterprise, and therefore the value of its securities, and causes that information to be reflected in the price of the security 'instantaneously'."[16] Thus, minority shareholders share in the gains expected by the controlling shareholder from the GPT. However, studies have shown that Canadian capital markets are not strong-form efficient[17] and the fact that insiders can earn abnormal returns by trading on the basis of non-public information supports such findings.[18] In the context of a GPT, the controlling shareholder may have access to non-public information and, absent any regulation, could benefit from the use of this information.[19]

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[13] See L. Lowenstein, "Management Buyouts" (1985) 85 Col. L. R. 730 at 750.

[14] See "Efficient Markets", *supra* note 8 at 65.

[15] See R.J. Daniels & J.G. MacIntosh, "Toward a Distinctive Canadian Corporate Law Regime" (1991) 29 Osgoode Hall L.J. 863 at 872.

[16] See "Efficient Markets", *supra* note 8 at 64.

[17] See Daniels & MacIntosh, *supra* note 15 at 873, n. 22.

[18] See H.N. Seyhun, "Insiders' Profits, Costs of Trading, and Market Efficiency" (1986) 16 J. of Fin. Econ. 189.

[19] Consider the claims of minority shareholders of Ford Motor Co. of Canada Ltd. who opposed the GPT initiated by its U.S. parent. Minority shareholders claimed that the controlling shareholder did not reveal enough information to decide whether the $185 offer was fair or not. In particular, Mackenzie Financial stated that "more detail is needed on Ford Canada's sensitivity to Canadian dollar changes and on the split of profits between manufacturing and sales" (G. Keenan, "Ford Canada buyout approved" *The Globe and Mail* [13 September 1995] B1).

Some proponents of the efficiency principle claim that even if some of the underlying assumptions of the efficient-markets hypothesis are not correct, the market will deter controlling shareholders from treating minority shareholders unfairly in the context of a GPT. A corporation which gains a reputation for squeezing-out minority shareholders at an inadequate price will be penalized by the market when raising equity capital in the future.[20] Either potential investors will choose not to purchase shares or they will only agree to purchase shares at a lower price. Thus, they insulate themselves against a potential loss if a GPT were to occur. As Wolfson explains, "[t]he probability of that adverse impact will act as a powerful deterrent against overreaching by corporate insiders."[21]

The effectiveness of this deterrence mechanism is questionable. First, in the context of a parent corporation taking its subsidiary private, there is little reason to believe that investors will apply this discount to future equity issues of the parent since it is unlikely that there will be a threat of a GPT in relation to the parent. This discount will be applied only to the equity of other subsidiaries. Second, GPTs do not occur frequently; they are often a once-in-a-lifetime event. Because they happen infrequently, the corporation may benefit from the short-term memory of investors; if the deterrent effect occurs at all, it may not extend beyond a short period of time. Third, there are a limited number of investment options which investors can pursue, particularly in the context of Canadian RRSP investments. As a result, it is improbable that investors will abstain from investing in a particular corporation simply because that corporation happened to treat its minority shareholders unfairly in the past. Investors' desire to maintain diversified investment portfolios will outweigh the desire to punish a company that squeezed-out its minority shareholders at a price which was perceived to be unfair.

Other proponents of the efficiency principle claim that the welfare of investors is maximized by a legal rule that permits unequal division of gains from GPTs, subject to the constraint that no investor be made worse off by the GPT.[22] This result is known in welfare economics as the Pareto criterion.[23] In discounting this claim, some advocates of the fairness principle argue that investors are indeed worse off if the price paid to minority shareholders is less than the purchase price that they originally paid. What these advocates of the fairness principle appear to ignore is that, in an efficient capital market, all historical price and volume data are incorporated into today's price. The fact that the corporation's share price was once higher than it is today does not indicate that it will rise again.[24] If the price paid to minority shareholders on a GPT is above the current market price, it is no less beneficial to the minority shareholders simply because the price was once higher. The controlling shareholder paying the

[20] See Wolfson, *supra* note 11 at 979.

[21] See *ibid.*

[22] See Lowenstein, *supra* note 13 at 750. See also F.H. Easterbrook & D.R. Fischel, "Corporate Control Transactions" (1982) 91 Yale L.J. 698 at 715.

[23] See Easterbrook & Fischel, *ibid.*

[24] See *ibid.* at 729.

above-market price will not profit from the GPT unless it increases the value of the target.

This disproportionate sharing of gains can be further justified by reference to the shareholders' agreement to contract *ex ante* on the basis that "they do not in substance own anything but are merely contracting out their capital ... the price at which they bought their shares already reflected the risks of a buyout."[25] On the one hand, when they purchased the shares, minority shareholders assumed the risk that they may be forced to sell the shares that they acquired. On the other hand, one could also argue that shareholders have certain expectations in contracting with a corporation whose majority seeks to squeeze them out. One of these expectations is that the minority will not be squeezed-out without sharing equally in the gains that result from the GPT. This argument is central to the fairness principle.

B. The Fairness Principle

In contrast to the efficient-markets hypothesis, the fairness principle is premised on the belief that the operation of a free market does not ensure that minority shareholders receive the fair value of their shares. In other words, "there can be a significant divergence between enterprise or share value and share price."[26] Some proponents of the fairness principle argue that minority shareholders must also receive the difference between the value of the shares and the market price of the shares. Others assert that fair treatment "requires not only that [minority shareholders] be given the value that they are compelled to surrender but also that they be given a share of the increment or of the opportunity which the insiders acquire by forcing them out."[27] Specifically, as a result of the squeeze-out, minority shareholders are unable to share in the gains the corporation makes upon taking advantage of corporate opportunities which would require shareholder approval.

Arguments that shareholders are entitled to fair treatment are sometimes translated into a doctrine of equality: minority shareholders expect to share equally per share with controlling shareholders in the gains resulting from the GPT.[28] Instead of aspiring towards this goal, controlling shareholders, as economic agents, will "take more than their aliquot share of the gains."[29] Because it frustrates the minority's expectations that they will share equally in the gains, a rule of unequal sharing is seen as unfair. Thus, if GPTs are permitted, regulatory bodies must implement measures that ensure that the minority shares equally in the gains of the transaction.

The difficulty with the fairness principle is not its underlying assumptions. Indeed, these assumptions seem to be sound. It is plausible that the controlling share-

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[25] Lowenstein, *supra* note 13 at 750.

[26] "Efficient Markets", *supra* note 8 at 66.

[27] V. Brudney, "A Note on 'Going Private'" (1975) 61 Va. L. Rev. 1019 at 1025 [hereinafter "Going Private"].

[28] V. Brudney, "Equal Treatment of Shareholders in Corporate Distributions and Reorganizations" (1983) 71 Cal. L. Rev. 1072 at 1131.

[29] *Ibid.* at 1132.

holder will seek to buy out the minority at the lowest price possible. In recent GPTs where U.S. parents have taken their Canadian subsidiaries private, the parents have made low-ball offers to the minority shareholders.[30] In response to the efficiency theorists' argument that the parent will likely be deterred by the need to raise future equity, advocates of the fairness principle would assert that in a GPT involving a U.S. parent and Canadian subsidiary, there will be no need to raise equity in Canada once the GPT has occurred unless the parent has other Canadian subsidiaries. Therefore, there will be no need to preserve the firm's reputation vis-à-vis public investors in Canada.

The overarching difficulty with the fairness principle lies in the seeming practical impossibility of determining what counts as a "gain" that must be shared. Advocates of the fairness principle readily acknowledge this shortcoming in their theory.[31] Is the gain received by the controlling shareholder measured by the number of shares that were acquired from the minority at a particular price? Is it measured by an estimation of the savings in agency costs and costs associated with servicing stockholders or by an estimation of the prospects of the company now that it is no longer publicly held? These difficulties manifest themselves particularly during appraisal proceedings wherein a court attempts to determine the dollar equivalent of the fair value of the target's shares. The difficulties raise a question with respect to the formulation of regulation: what extent of regulation is necessary to ensure that minority shareholders receive a fair price? A discussion of the regulation with respect to GPTs will explore the OSC's response to this question.

II. Evolution of the Fairness Principle and the Regulation of GPTs

Prior to 1977, the OSC did not specifically regulate GPTs. On 30 September 1977, the OSC introduced Policy 3-37.[32] The policy initially pertained to issuer bids — offers by an issuer to purchase, redeem or retire its own securities. It compelled timely disclosure of certain information contained in the issuer bid circular[33] and re-

[30] For example, in March 1995, the U.S.-based Dana Corp. originally offered minority shareholders of its Canadian subsidiary, Hayes-Dana Inc., $17.50 per share. The holder of the largest number of minority shares, the Ontario Municipal Employees Retirement Savings Board ("OMERS"), held out for $18.50. All shareholders were ultimately paid the higher price. In May 1995, Ford Motor Company initially offered $150 per share and eventually increased it to $185 per share because of minority claims that the price did not adequately reflect the value of the shares. See G. Keenan, "OMERS accepts new Dana offer" *The Globe and Mail* (19 April 1995) B4 and "Ford boosts bid for Canadian unit" *The Globe and Mail* (6 July 1995) B2.

[31] See "Going Private", *supra* note 27.

[32] (1977) O.S.C.B. 253 [hereinafter Policy 3-37]; amended (1977) O.S.C.B. 268; notices (1977) O.S.C.B. 273, (1978) O.S.C.B. 60; exemptions (1978) O.S.C.B. 114; amended (1978) O.S.C.B. 224; interpretation statement (1978) O.S.C.B. 323; draft amendment (1981) 1 O.S.C.B. 7E; addendum to draft (1981) 1 O.S.C.B. 24E; published as 9.1 (1982) 4 O.S.C.B. 538E; draft (1990) 13 O.S.C.B. 2021; replaced (1991) 14 O.S.C.B. 3345; amended (1992) 15 O.S.C.B. 2921.

[33] Policy 3-37, *ibid.*, indicated that the following items must be disclosed: benefits that would accrue to any senior officer, director or other insider of the issuer; any material changes, and "a summary of

quired the issuer to obtain an independent valuation in certain instances.[34] In subsequent amendments to Policy 3-37, the OSC extended the Policy to a takeover bid made by any insider of the issuer or any associate or affiliate of the insider.[35] Although the term "going-private" was not found in these amendments, their effect was to bring GPTs within the purview of Policy 3-37.[36]

A significant turning point in the history of GPTs came with the OSC's decision in *Re Cablecasting Ltd.*[37] In that case, a shareholder requested the OSC to issue a cease-trade order to prevent Cablecasting from squeezing-out its minority shareholders. The shareholder argued that the information circular failed to comply with the disclosure requirements in Policy 3-37 with respect to the preparation of a valuation and that a more elaborate regulatory structure must be in place before a squeeze-out is permitted.[38] The OSC refused to issue the cease-trade order but it did state in its decision that it would review Policy 3-37.[39] The OSC subsequently requested that a memorandum on the subject of GPTs be prepared by the Director of the Commission, Charles Salter.

The primary conclusion of the Salter Memorandum[40] was that the OSC need not prohibit GPTs but that it was appropriate to regulate them in order to ensure that they remained fair to all shareholders.[41] Fairness should be determined by weighing a number of factors, including: whether a majority of the minority vote would be taken; whether an independent representative of the minority negotiated the transaction; what tax consequences would accrue to the minority shareholders; whether an appraisal remedy was available; and whether there was a valid business purpose.[42] The Salter Memorandum ultimately concluded that an independent valuation should be mandatory.

In July 1978, the OSC issued a notice in which it reviewed the results of its deliberations on the Salter Memorandum and prescribed specific rules to govern GPTs.[43] The OSC rejected the fairness test proposed by the Salter Memorandum. In its view,

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any appraisal or valuation known to the directors or officers [completed] ... within two years preceding the date of the bid" (*ibid.* at 258).

[34] Policy 3-37, *ibid.* at 262.

[35] (1977) O.S.C.B. 273. The rule applied only if the bid was for more than 5 per cent of the outstanding shares of the issuer and if the change was intended to compel any shareholder to terminate his or her interest in the issuer.

[36] For a commentary on the history of Policy 3-37, see P.G. Findlay, "The History and Scope of Policy 9.1" in *OSC Policy 9.1: A Practical Approach to Related Party Transactions* (Mississauga: Insight, 1991) 1 at 3.

[37] (1978) O.S.C.B. 37.

[38] See *ibid.* at 46.

[39] See *ibid.* at 48.

[40] 17 May 1978. The Salter Memorandum was not a published document but is on file with the Ontario Securities Commission.

[41] *Ibid.* at 60ff.

[42] *Ibid.*

[43] "'Going Private' Transactions, Including Comments as to Other Issuer Bids and Insider Bids" (1978) O.S.C.B. 214 [hereinafter 1978 Notice].

the test was too imprecise and would be unnecessary if the GPT were accepted by a majority of the minority shareholders.[44] The 1978 Notice did not, however, abandon the fairness principle altogether. In the opinion of the OSC, "the question to be resolved is the nature of the rules that should be applied to ensure that these transactions [*i.e.* GPTs] are implemented on a basis that is not unfair to the minority."[45] The OSC implemented mandatory valuations, majority of the minority voting and disclosure requirements.[46] It thus retained its commitment to the fairness principle but chose to rely on procedural rules to ensure that minority shareholders receive fair treatment. This approach continued to motivate the OSC in its formulation of regulation governing GPTs. As Anisman notes, the Commission's approach "emphasizes structural and procedural provisions rather than determinations of substantive fairness in each case ... the Commission would prefer not to become a regular arbiter of substantive fairness."[47]

In 1982, the OSC issued Policy 9.1 ("Original 9.1") which covered GPTs, issuer bids and insider bids.[48] Original 9.1 required an acquiror to have a valuation prepared in accordance with certain procedures.[49] It was also mandatory for the acquiror to obtain minority approval of the GPT. If the consideration were payable wholly or partly in cash or was less than the mid-point of the range of per security values disclosed in the valuation, then two-thirds minority approval would be required.[50] In any other case, majority of the minority approval was sufficient. Finally, disclosure of relevant items (including reasons for the GPT, material changes in the affairs of the issuer, tax consequences and a summary of the valuation) was required in an information circular.

On 23 May 1990, the OSC introduced a revised version of Original 9.1 for comments.[51] Instead of waiting for comments before implementing the new policy, the OSC warned that those issuers which did not comply with it might be immediately subject to administrative proceedings and appropriate sanctions.[52] On 5 July 1991, the OSC published another version of Policy 9.1 which was amended on 26 June 1992[53] and which continues to goveru GPTs today.[54]

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[44] *Ibid.* at 220.

[45] *Ibid.* at 216.

[46] *Ibid.*

[47] P. Anisman, "The Commission as Protector of Minority Shareholders" in *Securities Law in the Modern Financial Marketplace: Special Lectures of the Law Society of Upper Canada* (Toronto: De Boo, 1989) 45 at 473.

[48] See (1982) 4 O.S.C.B. 538E.

[49] *Ibid.*, ss. I.C.4, II.A.

[50] *Ibid.* s. II.B.1.(a).

[51] (1990) 13 O.S.C.B. 2021.

[52] *Ibid.* at 2021.

[53] (1991) O.S.C.B. 3345, amended (1992) O.S.C.B. 2930.

[54] This revised version of Original 9.1 and the amendments that follow it will be referred to collectively as Revised 9.1. or Policy 9.1, *supra* note 1.

Revised 9.1 significantly increased the regulation of GPTs. While retaining the disclosure, valuation and minority approval requirements of Original 9.1, it specifies detailed procedures that must be adopted in the fulfillment of these requirements. First, Revised 9.1 requires that the valuation be prepared by a qualified and independent valuer.[55] This valuer must have regard to a number of different valuation approaches[56] and must consider factors particular to the issuer, such as recent purchases or sales of companies, assets and liabilities.[57] The valuer must also prepare a formal valuation report which contains specific information with respect to the issuer and the method of valuation.[58] Second, Revised 9.1 requires extensive disclosure in the information circular of a number of items, including a detailed summary of the valuation.[59] Third, Revised 9.1 strongly recommends that target companies establish special committees of independent directors, and sets forth considerations to be taken into account when assessing independence.[60] Fourth, Revised 9.1 retains minority approval voting requirements.[61]

The increased regulation in Revised 9.1 — particularly the regulation with respect to valuations and special committees — highlights a fundamental assumption of the OSC in its approach to regulating GPTs. In formulating regulation, the OSC has assumed that the market cannot be relied upon to ensure that minority shareholders receive a fair price for their shares. This assumption directly opposes the views of efficiency theorists who postulate that regulation is unnecessary to ensure that minority shareholders receive a fair price on a GPT. In Revised 9.1, the OSC demonstrates its commitment to the fairness principle:

> The Commission regards it as essential that all security holders be treated in a *manner which is fair and which is perceived to be fair.* Issuers and others who benefit from access to the capital markets assume an obligation to treat security holders fairly. The fulfilment of this obligation by issuers and their related parties is essential to the public interest in maintaining capital markets which operate efficiently, fairly and with integrity.[62]

Little, if any, regard has been paid by the OSC to the efficient operation of capital markets. Rather, by implementing Revised 9.1, the OSC seeks to address not only the

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[55] *Ibid.*, s. 24.3(6).

[56] *Ibid.*, s. 24.3.

[57] *Ibid.*

[58] *Ibid.*, s. 24.

[59] *Ibid.*, s. 24.5.

[60] *Ibid.* s. 27. Revised 9.1 also introduces regulation with respect to a type of transaction which it calls a "related-party transaction" ("RPT"). Under Revised 9.1, if a transaction does qualify as a RPT, the issuer must comply with requirements that are similar to those governing GPTs, see Revised 9.1, *ibid.*, s. 17. If a transaction happens to fall outside the definition of a GPT in Revised 9.1 because minority shareholders are receiving an interest of equivalent value in another participating security, the transaction will nevertheless be bound by the rules with respect to RPTs. The Proposed Revised Rules, *supra* note 3, seek to correct this anomaly by referring to a transaction in which minority shareholders receive an interest of equivalent value as a "quasi-going-private transaction."

[61] *Ibid.*, ss. 30, 31.

[62] *Ibid.*, s. 1.1 [emphasis added].

unfairness but also the appearance of unfairness of GPTs. The OSC's move from attending to issues of unfairness to issues of perceived unfairness is significant. Even though a particular transaction may not itself be unfair, mere perception warrants increased regulation.

Since the implementation of Revised 9.1, the OSC has remained wedded to the view that the regulation in the Policy, and indeed increased regulation, is necessary to preserve "adequate investor protection".[63] In May 1996, the OSC introduced for comments its "Notice of a Proposed Rule and Policy Under the *Securities Act* (Ontario) — Insider Bids, Issuer Bids, Going Private Transactions and Related Party Transactions."[64] The Proposed Revised Rules were formulated after the OSC was granted rule-making authority pursuant to the *Securities Amendment Act*.[65] As soon as the Proposed Revised Rules become a rule pursuant to the SAA, they will have the force of law.[66]

The Proposed Revised Rules do not alter the rules with respect to GPTs significantly.[67] However, the Rules do endorse the previous approach in Policy 9.1 of addressing transactions that are unfair or that are perceived to be unfair by resorting to additional regulation. In response to the criticism that Policy 9.1 goes too far, the OSC cites a practitioner who states that Policy 9.1 has "served a useful role in sensitizing the community to the need to ensure adequate safeguards are provided when proceeding with a transaction that involves actual or potential conflicts of interest."[68] However, the key issue is whether the safeguards contained in Policy 9.1 are indeed adequate. One response to this query would be that even if the regulation in Policy 9.1 does not protect minority shareholders against all instances of unfairness, it certainly attacks instances of perceived unfairness.

There is an inherent ambiguity in the use of the word "fair" in Policy 9.1. The Policy does not define the terms "fair" or "perceived to be fair." In the absence of any such definitions, the meaning of "fairness" in the Policy is open to speculation. Instead of relying on procedural rules designed to convince minority shareholders that they are being treated fairly, a conception of fairness that is directly related to the price that minority shareholders receive on a GPT should be adopted. For minority

[63] Comments by Brenda Eprile, Executive Director of the OSC, cited in (1996) 19 O.S.C.B. 2961.

[64] *Ibid.* at 2981. See also *supra* note 3.

[65] S.O. 1994, c. 33 [hereinafter SAA]. Note that the SAA was passed in 1994 following the recommendations of Ontario's Task Force on Securities Regulation. See *Responsibility and Responsiveness: Final Report of the Ontario Task Force on Securities Regulation* (Toronto: Queen's Printer, 1994). The SAA grants the OSC the ability to make rules provided that the OSC adheres to a statutory public notice and comment period, see SAA, s. 143. In particular, s. 143(13) states that a rule has the "same force and effect as a regulation," except that it is passed by the OSC and not Cabinet and that it is not subject to certain requirements contained in the *Regulations Act*, R.S.O. 1990, c. R-21.

[66] It is not clear whether all of Policy 9.1 will become a rule or whether it will be reformulated as a rule and companion policy statement. See Proposed Revised Rules, *supra* note 3 at 2983.

[67] See *supra* note 3 at 2985 in which the OSC states that the Proposed Revised Rules "would regulate going private transactions in substantially the same manner as they are currently regulated."

[68] *Ibid.* at 2982-83.

shareholders, the key issue with respect to fairness is the price they receive for their shares. The implementation of procedures to eliminate perceptions of unfairness is of little use if these procedures do not ensure that shareholders actually receive a higher price than that which they would have received without them. Rather than focus on fairness and perceived fairness in a seemingly abstract sense, the Policy ought to specify that these two terms refer to the price minority shareholders actually receive. Once a conception of fairness based on price is adopted, there will be no need to be concerned with perceptions of fairness. If minority shareholders receive a fair price, there will be no perception of unfairness.

III. The Four Pillars of Policy 9.1

What are the policy implications of this argument? If a conception of fairness based on price is adopted, then it must be ensured that minority shareholders are provided with the opportunity to assess whether they are receiving a fair price for their shares. In order to do this, two of the four pillars of Policy 9.1 are necessary — disclosure and majority of the minority approval requirements. However, it is argued that a conception of fairness based on price does not warrant the other two pillars — the valuation requirement and the recommendation that the target establish a special committee of independent directors.[69]

A. Disclosure

Policy 9.1 calls for extensive disclosure in an information circular to be prepared and mailed to each shareholder prior to the shareholders' meeting to approve the GPT.[70] The information circular must contain, among other things, a description of rights available to shareholders who oppose the transaction, a detailed summary of an independent valuation and any prior valuation involving the target or a substantial part of its business.[71]

As previously discussed, in markets that are strong-form efficient, all relevant information with respect to the value of the share is contained within its market price. However, as mentioned, studies have shown that capital markets in Canada are not

[69] The Proposed Revised Rules relating to Policy 9.1 propose the retention of all four facets of Policy 9.1. See *supra* note 3 at 2961. This argument becomes more persuasive when one considers empirical evidence with respect to GPTs in Canada. See A.I. Anand, "Fairness, Efficiency and Policy 9.1: Are Going-Private Transactions Over-regulated", Law and Economics Workshop Series, 27 September 1996 (on file with the Canadian Law and Economics Association). As part of the paper, a study of 55 acquisition transactions which occurred in Canada between 1986 and 1995 was completed. The study suggested that the additional regulation in Policy 9.1 does not result in minority shareholders receiving increased premiums on GPTs. In particular, no empirical evidence was found to support the claim that returns to minority shareholders after the enactment of Policy 9.1 were higher than they were prior to the implementation of the Policy.

[70] See Policy 9.1, *supra* note 1, s. 12.

[71] See *ibid.*

strong-form efficient.[72] In other words, market price may not indicate value where certain information with respect to a company is not embedded in the market price of its shares. If it is accepted that capital markets are not strong-form efficient, it follows that disclosure is necessary to ensure that majority shareholders do not exploit non-public information to the detriment of minority shareholders. Hence, disclosure of non-public information such as prior valuations is warranted as is disclosure of material changes.[73]

What information is relevant? Proponents of the fairness principle would argue that disclosure requirements must be strict and would likely contend that most information with respect to insiders is relevant. They would assert that minority shareholders ought to know, for example, the extent to which insiders benefit from the GPT.[74] This view is motivated by the concern that minority shareholders are entitled to share equally in the gains that result from the GPT. However, the threshold for disclosure should be whether the information would lead minority shareholders to demand a higher price for their shares. If so, such information is relevant and ought to be disclosed.

B. Majority of the Minority Voting

Policy 9.1 provides that minority shareholders must approve a GPT. A simple majority of the minority vote will be required if the consideration is cash only and if the price offered is at least equal to or above the mid-point of the high and low ends of the valuation. A two-thirds majority is required if the consideration is wholly or partly non-cash or if it is less than the mid-point of the valuation.[75]

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[72] See Daniels & MacIntosh, *supra* note 15 at 873, n. 22.

[73] Policy 9.1, *supra* note 1, ss. 4, 8, 12, 17 compel disclosure in the proxy material as well as in press releases and material change reports that are filed with the provincial securities regulators. In the recent Ford GPT, the Ontario Securities Commission engaged Gordon Capital Corp. to assist it in determining whether the minority shareholders of Ford Motor Company of Canada were provided with enough information to decide whether an offer to buy them out at $185 per share was adequate. Mackenzie Financial Corp., the largest minority shareholder, and other institutional investors claimed that Ford Canada should have provided better disclosure about its sensitivity to exchange rate fluctuations and division of profit between manufacturing and sales. See E. Heinrich, "OSC probing Ford's disclosure to holders" *The Financial Post* (14 September 1995) 5.

[74] Note the GPT completed in August, 1995 by Service Corporation International, a U.S. parent, and Service Corporation International (Canada) Limited, its Canadian publicly-held subsidiary. At the time of the GPT announcement, there were approximately three million common shares of the subsidiary held by minority shareholders. There were also outstanding stock options for the purchase of over one million additional common shares. As disclosed in the Management Information Circular of the subsidiary dated 24 July 1995, a large number of these stock options were held by senior officers of the parent.

[75] See Policy 9.1, ss. 30.1, 31.1. Section 15.2(2) of Policy 9.1 allows an exemption from the minority-approval requirements if a person or company holds ninety percent or more of the target's securities at the time of the GPT and either the appraisal remedy is available to shareholders or such shareholders are provided with an enforceable right that is substantially equivalent.

A sound argument in favour of minority approval rests on democratic principles: if minority shareholders are going to be forced to sell their shares, then certainly they should be permitted to approve the price at which they will sell them. By providing the minority with a separate opportunity to approve the GPT, controlling shareholders are prevented from using "their voting power to favour their own interests over those of the minority."[76] Also, given that GPTs occur infrequently and that their occurrence is unpredictable, the market price of a company's shares may not reflect the risk that a GPT will occur. Minority approval requirements offset this risk by enabling minority shareholders to reject an unanticipated or unsatisfactory offer. Furthermore, separate minority approval gives meaning to disclosure requirements. It would be meaningless for minority shareholders to receive information, on the basis of which they formulate informed opinions with respect to the value of their shares, unless those shareholders had the power to reject an unreasonable offer.[77]

One reason why the minority approval requirement is particularly effective is that often large blocks of the minority shares are held by institutional investors such as banks, trust companies, pension funds, insurance companies and mutual funds.[78] By issuing press releases and making public announcements with respect to their voting intentions, they inform other minority shareholders of their views with respect to the fairness of the offer.[79] In this way, retail investors are able to "free ride" on the sophistication of the institutional investor.[80] Retail investors also benefit from the institution's obstinacy at holding out for a price that does not meet the institution's satisfaction.[81] If a shareholder tenders to the offer and the institutional shareholder holds out for and ultimately receives a higher price, all shareholders receive the higher price.[82]

[76] J.G. MacIntosh, "Corporations" in *Fiduciary Duties: Special Lectures of the Law Society of Upper Canada* (Toronto: De Boo, 1991) 189 at 241.

[77] Recent GPTs suggest that the minority voting requirement operates effectively; where an offer is unacceptable to minority shareholders, they reject it or even hold out for a higher price. In 1993, Goodyear Tire & Rubber Co. sought to take the minority shareholders of its Canadian subsidiary private at $48 per share. The minority shareholders rejected the offer but when the parent increased the price to $65 per share, they overwhelmingly approved the transaction. Similarly, in 1994, U.S.-based Texaco Inc. offered to buy out the minority shareholders of its Canadian subsidiary at $1.40 a share. The minority shareholders, led by Canadian 88 Energy Corp., rejected the offer. In 1995, the minority shareholders, led by Canadian 88 again, agreed to be bought out at $1.48. See *supra* note 32 for a discussion of the Dana Corp. GPT. See also G. Keenan, "OMERS blocks Dana bid" *The Globe and Mail* (29 March 1995) B20; B. Jang, "Texaco closes in on control of Canadian operation: Largest minority shareholder agrees to sell 9.8% stake" *The Globe and Mail* (14 April 1995) B4; and J. Kazanjian & M. McNee, "Tensions in Corporate Governance: Minority Shareholders in U.S. Controlled Canadian Public Companies" (1995) 7 Corp. Gov. Rev. 1.

[78] See J. MacIntosh, "The Role of Institutional and Retail Investors in Canadian Capital Markets" (1993) 31 Osgoode Hall L.J. 373 at 383.

[79] See G. Keenan, "Ford Canada buyout approved: Angry dissenters say offer still too low" *The Globe and Mail* (13 September 1995) B1.

[80] See MacIntosh, *supra* note 78 at 376.

[81] See *ibid.* at 377.

[82] See Policy 9.1, s. 32.1. See also *supra* note 30 which discusses the Dana Corp. GPT in which OMERS held out for, and ultimately received, a higher price for all shareholders.

It is arguable that the presence of institutional investors reduces the need to have a two-thirds voting requirement, which is triggered if the offer price is less than the mid-point of the high and low ends of the valuation range. The higher approval threshold seems to be justified since the offer price is less likely to be fair if it lies at the lower end of the valuation range. This risk necessitates more stringent approval requirements to protect minority shareholders. However, institutional investors are sophisticated investors who assess the fairness of the GPT on their own and often through valuations that are generated internally. By negotiating with the controlling shareholder or holding out for a higher price, institutional investors reduce the need for minority shareholders to be protected by this high approval threshold. Indeed, as MacIntosh argues, the presence of institutional shareholders enhances market efficiency and therefore reduces the need for regulation generally.[83]

Some scholars argue that although majority of the minority approval is an effective mechanism for ensuring that minority shareholders are treated fairly, it should not be regarded as "a complete certification of fairness."[84] Daniels and MacIntosh contend that shareholders will be inhibited from dissenting because of management control of disclosure and shareholder collective action problems. These problems will be particularly severe in the secondary market in which retail shareholders are prevalent. These shareholders do not "take the time to inform themselves adequately to wield their votes effectively: many simply will return their proxies to management without reviewing the proxy material or will fail to return their proxies at all."[85]

Daniels and MacIntosh are correct in pointing to disclosure of information as a necessary element in a shareholder's ability to make meaningful judgements with respect to a GPT. All shareholders — whether they are institutional or retail — should be entitled to make their respective decisions on a fully-informed basis. In addition, it is true that shareholders may not always co-ordinate themselves to vote collectively one way or another on a GPT. To what extent, however, should regulation take into account that retail shareholders may be apathetic? The transaction will be fair if it provides information on which shareholders can make an informed decision. Whether shareholders actually choose to review the information and make the decision is a matter outside of the controlling shareholder's and the regulator's concern.

C. Valuations

Policy 9.1 compels the target corporation to have a valuation prepared by a valuer that is "qualified and independent".[86] Under Policy 9.1, "the purpose of a formal valuation is to provide an objective assessment of value to permit security holders to form a reasoned judgment concerning a transaction."[87] The valuer must give an opin-

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[83] See MacIntosh, *supra* note 78.

[84] Daniels & MacIntosh, *supra* note 15 at 931.

[85] *Ibid.* at 931-32.

[86] Policy 9.1, *supra* note 1, ss. 13, 22-26. Section 26.1 states that the valuation may be waived upon application by the target to the Director.

[87] *Ibid.*, s. 22.1.

ion with respect to the "value or range of values" of the shares.[88] The wording of Policy 9.1 suggests that the valuation will be prepared under the supervision of the special committee and that value will be determined by the valuers alone, once they review "all relevant information".[89] However, in practice, the valuation requirement presents various difficulties. To begin, the OSC itself has noted that disclosure in the valuation is often unsatisfactory.[90] The OSC reached this conclusion on the basis of a report prepared by the Canadian Institute of Chartered Business Valuators which concluded that the disclosure in more than half of the opinions reviewed was inadequate.[91] In addition, an intense negotiation process usually occurs in which the controlling shareholder, the special committee, the valuer and officers of the target seek to arrive at a range that is satisfactory to all parties. This negotiation process undermines the objective assessment of value. If an assessment is objective, it is doubtful that it can be reached through a negotiation process between interested parties.[92]

Further impeding the objective assessment of value is the financial incentive that valuers have in arriving at a price that meets management's approval. While valuers may ostensibly be independent, they wish to retain their customers. A valuer which anticipates receiving business in the future will have "an incentive to arrive at a result congenial to management, who will decide the disposition of future business."[93] In its Proposed Revised Rules relating to Policy 9.1, the OSC states that it does not find it "troublesome" that independent valuers may have a relationship with management, and particularly independent directors.[94] This statement evidences a change from Policy 9.1 which states that valuers must be independent from any interested party.[95]

While the independence of valuers may be questionable, it appears as though Daniels and MacIntosh have overstated the case when they assert that "[i]t is virtually unheard of for an investment banker or other valuer to deliver a fairness opinion or valuation that does not reflect management's view."[96] First, the negotiation process

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[88] *Ibid.*, s. 24.3(2).

[89] *Ibid.*, s. 24.3(1).

[90] Proposed Revised Rules, *supra* note 4 at 2990.

[91] (1993) 18 O.S.C.B. 5014.

[92] Some may argue that the fact that each of these parties is involved in reaching a decision with respect to the range ensures that the process is legitimate; it is akin to negotiation between arm's-length parties. But if the process is akin to arm's length negotiation, then representatives from the group of minority shareholders should certainly be seated at the bargaining table.

[93] Daniels & MacIntosh, *supra* note 15 at 925; see also Anisman, *supra* note 47 at 469-72.

[94] See *supra* note 3 at 2988.

[95] See Policy 9.1, *supra* note 1, ss. 23.4, 23.5. It is also questionable how relevant an externally generated valuation is to shareholders. Institutional shareholders usually prepare their own valuation when deciding whether to tender to a GPT. Although the valuation may be of interest to retail investors, there are numerous other factors such as the investors' individual financial circumstances, the price at which they bought their shares, the advice of their professional advisors and news regarding the intentions of institutional investors which tend to influence their decisions regarding the GPT. In short, it is unclear how useful a valuation is to minority shareholders.

[96] *Supra* note 15 at 925. Note the lack of independence of the special committee in the Ford transaction. The special committee of the Canadian subsidiary retained Wood Gundy Inc. to prepare the valuation. However, two of the four members on the special committee were also directors of the Ca-

would not be as intense as it is unless the valuer held a particular view about the proper valuation range of the shares. Second, valuers have their own reputation to protect; they may pay more than mere lip-service to the requirements in Policy 9.1 to avoid the presumption made by either the OSC or retail shareholders wishing to deal with the valuer's firm that this valuer engages in shoddy practice. Such a presumption would also have a negative impact on the valuer's public relations. Third, valuers who are closely related to management frequently do business with institutional investors who may be the minority shareholders in a GPT. Valuers thus have some incentive to provide an opinion acceptable to all parties, management and minority shareholders alike.

The difficulties with the valuation requirement are not only that valuers are rarely independent. Determining value itself is, in many cases, a very difficult, if not impossible task. Consider the Ford GPT in which a number of valuations have been and are being prepared. Prior to proposing the GPT to its Canadian subsidiary, U.S.-based Ford Motor Company retained a valuer who concluded that the fair market value of the subsidiary's shares was in the range of $110 to $150 per share. Ford U.S. proposed the GPT to minority shareholders at $150 per share. The special committee of the subsidiary then retained a valuer that stated that the fair market value of the shares was in the range of $170 to $200. The minority shareholders were then offered $185 per share. Though Ford Canada was able to complete the GPT without the approval of minority shareholders,[97] some minority shareholders are exercising their appraisal right and have commissioned their own valuation. A Montreal firm also issued a subsequent valuation stating that the shares are worth up to $750 each.[98]

It may be impossible to value the shares of Ford Canada and to reach a value with which all parties, including minority shareholders, would agree represents the value of the shares. This raises the question of whether the rules with respect to valuations in Policy 9.1 are effective: do valuations make it more likely that minority shareholders will receive a fair price for their shares? It is simply not possible to provide an adequate response to this question without empirical evidence to support the response.[99] Without such evidence, it could be argued that the extensive regulation in

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nadian Imperial Bank of Commerce, Wood Gundy's parent company. Almost any test with respect to independence would point to the lack of independence and potential conflict of interest here. See G. Keenan, "Ford Pouring Millions into Oakville" *The Globe and Mail* (17 May 1995) B1.

[97] The Ford GPT was exempt from minority approval requirements under section 15.2(2) of Policy 9.1, *supra* note 1. Ford Canada owned more than ninety percent of the shares and the minority shareholders had the option of relying on the appraisal remedy.

[98] Sce E. Heinrich, "Market speculates parent will raise Ford Canada bid" *The Financial Post* (5 May 1995) 5.

[99] One may ask what type of empirical evidence would be useful in this endeavour. Comparative empirical data with respect to premiums prior to and subsequent to the imposition of the more stringent valuation requirements in Policy 9.1 (May 1990) could be collected. In addition, it may be useful to compare premiums in GPTs in which an exemption from the valuation requirements was obtained against GPTs in which valuations were prepared in accordance with Policy 9.1. It would also be useful to update a study completed by B. Amoako-Adu & B. Smith, "Minority Buyouts and Ownership Characteristics: Evidence from the Toronto Stock Exchange" (1992) 21 Fin. Man. 41, discussed in Anand, *supra* note 69.

place with respect to valuations in Policy 9.1 is unnecessary since it does not result in an increase in the price received by minority shareholders.

D. Special Committees

Policy 9.1 does not require the target board of directors to establish a special committee of independent directors; it merely states that it would be "good practice" to do so.[100] Though this is currently only a recommendation, the formation of a special committee by the target in a GPT has been established by practice. In an ideal world, such a committee would alleviate the inherent conflict between management and the controlling shareholder on the one hand, and the minority shareholders on the other. As a body comprised of persons without an economic interest in the GPT, the special committee selects an independent valuer, supervises the preparation of the valuation, reviews it and makes decisions with respect to its assumptions. The special committee makes a recommendation to the board which, in turn, makes a recommendation to the shareholders as to the fairness of the GPT.

Often, the ostensibly independent director is not, in fact, independent.[101] It is common for directors to share a social bond with the controlling shareholder and fellow directors, which they do not share with widespread groups of minority shareholders.[102] There is, in Canada, a small pool of individuals from which to choose independent directors.[103] Independent and non-independent directors will often have served together on various boards or will have become acquainted in other circles. Management chooses its independent directors but, rather than viewing the special committee as a truly independent and neutral entity, it usually views it as a body that legitimizes the transaction. The special committee often serves to "freshen the atmosphere".[104] Indeed, in the context of a GPT, it seems that independent committees rarely deviate from supporting management's proposal.

Thus, one of the primary consequences of having a special committee is that it gives an aura of legitimacy to the GPT. This consequence is relevant to the consideration of whether the special committee is a necessary aspect of the regulation governing GPTs. The mere implementation of procedural rules does not necessarily ensure that substantive fairness will be achieved. The strong recommendation that management establish a special committee is but one example of the way in which Policy 9.1

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[100] In insider bids, it is mandatory that a special committee of independent directors supervises the valuation; see Policy 9.1, *supra* note 1, s. 5.

[101] For a discussion of independent directors, see V. Brudney, "The Independent Director — Heavenly City or Potemkin Village?" (1982) 95 Harv. L. R. 597.

[102] See Anisman, *supra* note 47 at 470.

[103] See J.G. MacIntosh, "Corporate Governance in Canada: A Broad-Brush Assessment" in *Securities Regulation: Issues and Perspectives* (Scarborough: Carswell, 1994) at 327-28.

[104] See Daniels & MacIntosh, *supra* note 15 at 931; Daniels & MacIntosh borrow this idea from *Gottlieb* v. *Heydon Chemical Corp.*, 91 A. 2d. 57 at 59 (Del. S.C., 1952).

provides a procedural safe harbour which insulates what may be a suspect GPT from the scrutiny of the regulator.[105]

An independent committee may be viewed as a useful tool in the OSC's endeavour to combat perceived as well as actual unfairness. Once again, the possibility that independent directors are not in fact independent merely points to a deeper difficulty in Policy 9.1 itself: it is not certain whether independent directors are useful in ensuring that minority shareholders receive a fair price. Empirical studies such as whether special committees actually contribute to higher prices for minority shareholders are necessary before this additional regulation should be endorsed.

E. Why Two Pillars Must Be Retained

It could be asserted that the argument that only two of the four pillars should be retained does not necessarily follow from the contention that fairness ought to be based on price. First, there is no empirical evidence which indicates that the disclosure requirement and the majority of the minority voting requirement lead to higher prices for minority shareholders on a GPT.[106] Second, if fairness is defined by price and price alone, then why do shareholders need to receive a disclosure document and have the right to vote at a shareholders' meeting? If they are not offered a price which they consider to be fair, they should simply refuse to tender to the offer. After all, shareholders usually have a dissent right which enables them to receive the fair value of their shares.[107]

The argument for retaining the disclosure requirement and majority of the minority approval requirement is derived from the efficiency principle. If it is accepted that capital markets in Canada are not strong-form efficient, then there should be a requirement compelling a corporation to disclose information which is not publicly available but which could effect the market price of the shares. Otherwise, minority shareholders would be unable to make a decision with respect to whether a particular offer is fair because they would not have all relevant information at their disposal. If shareholders are presented with information, on the basis of which they formulate a decision to tender to the GPT, then it follows that they ought to be provided with a forum within which they can vote against an unfair price. Dissent rights are insufficient in such a context; the exercise of these rights is complex and technical which explains why these rights are rarely exercised. In addition, dissent rights force the courts to

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[105] See Daniels & MacIntosh, *ibid.* at 931. See also Anisman, *supra* note 47 at 473.

[106] The issue of empirical evidence is discussed in the conclusion below.

[107] Most Canadian corporate statutes provide for an alternative remedy through the exercise of dissent rights if one of the minority shareholders does not wish to receive the consideration being offered by the acquiror as part of a GPT. Common shares held by the dissenting shareholders are not converted into preferred shares but are acquired by the target. The shareholder is entitled to apply to a court to have the fair value of the shares determined if the shareholder and the target cannot agree on a price. See *e.g.* the CBCA, *supra* note 5, s. 190(3) and the *Business Corporations Act*, R.S.O. 1990, c. B-16, s. 185(4).

determine the fair value of the dissenter's shares and it is questionable whether the court system is the appropriate forum for deciding fair value.

While the argument above underscores the importance of the disclosure and majority of the minority voting requirements, it does not call for the retention of the valuation and special committees provisions of Policy 9.1. Admittedly, these two provisions may be responses to concerns of perceived unfairness. However, in light of the revised conception of fairness based on price proposed in this article, it must be asked whether these aspects of Policy 9.1 are effective and, if so, whether the costs imposed by this regulation are justified by the benefits it creates for minority shareholders.

Conclusion

There is no empirical evidence which definitively responds to the question of which, if any, provisions in Policy 9.1 should be retained. In fact, the implementation of regulation without supporting empirical evidence is a weakness which pervades securities regulation in Canada generally. Without the benefit of empirical evidence, it is impossible to know whether proposed regulation is necessary and, if so, whether it will be effective in achieving the desired results. As a general practice before implementing regulation, securities regulatory authorities should solicit, commission or conduct empirical studies with the objective of enabling regulators to assess the costs of the proposed regulation. They should also consider whether these costs outweigh the benefits of the regulation to market participants. In some cases, it may be impossible to assess the usefulness of regulation unless the regulation is implemented and in force. In these cases, the regulation could be "sun-setted" for a limited period of time. Such a testing period would enable regulators to repeal implemented regulation which proved to be ineffective or too costly when compared to the benefits it provides.

For market participants, empirical evidence is necessary because as regulation becomes more stringent and more complex, it also becomes more costly. Under Policy 9.1, costs stem from the obligation to hire an independent valuer, to form a special committee of independent directors, to compile an information circular and circulate it to shareholders, and to hold a shareholders' meeting. The existence of these costs does not mean that GPTs should not be regulated. But they do raise the question of the effectiveness of Policy 9.1. Does it fulfill its objectives and do the benefits of the regulation outweigh the costs?[108]

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[108] See Anand, *supra* note 69. See also MacIntosh, *supra* note 103 at 322, where it is stated that,

> regulation which seeks to completely eliminate all failure, or to eliminate all wrongdoing, is not cost-effective regulation. All regulation is costly, both because of the direct and opportunity costs of compliance. The question is, and must always be, whether additional regulation is *cost-effective*. The cost-effectiveness criterion essentially reduces to this: does the new regulation produce at least as much wealth as it costs to implement? [emphasis in original].

Unlike securities regulatory authorities in Canada, the U.S. Securities and Exchange Commission ("SEC") explicitly recognizes the usefulness of empirical data. In soliciting comments on its proposals, the SEC urges commenters to provide empirical evidence relating to the issues considered by the particular proposal in order to assess whether proposed regulation will promote the efficiency of securities markets and the confidence of market participation.[109] With such evidence, the SEC focuses on and attempts to evaluate the economic impact of proposed rules.

Securities regulators in Canada should follow the approach of the SEC in this regard. In order to justify regulation, regulators bear some burden of providing tangible evidence that the regulation is necessary, that it will accomplish the desired results and that the benefits received by market participants will justify the costs imposed by the regulation. Otherwise, regulation may be inappropriately and unnecessarily implemented. Ultimately, it will be market participants who bear the costs of such practice.

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[109] See *e.g.*: SEC Release No. 33-7393, "Delayed Pricing for Certain Registrants" *SEC* (20 February 1997) 383 (LEXIS/NEXIS); SEC Release No. IC-22530, "Investment Company Names" *SEC* (27 February 1997) 472 (LEXIS/NEXIS); SEC Release Nos. 33-7399, IC-22529, "Proposed New Disclosure Option for Open-End Management Investment Companies" *SEC* (27 February 1997) 474 (LEXIS/NEXIS); SEC Release Nos. 33-7398, 34-38346, IC-22528, "Registration Form Used by Open-End Management Investment Companies" *SEC* (27 February 1997) 485 (LEXIS/NEXIS).