
Regulating Issuer Bids: The Case of the Dutch Auction

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Under current securities legislation in Ontario, conventional issuer bids are subject to both "identical consideration" and "pro rata take-up" requirements. A variation of the conventional issuer bid, known as a "Dutch auction" issuer bid, has started to gain prominence in Canada as a mechanism of share acquisition used by issuers to repurchase a portion of their outstanding shares. While Dutch auction issuer bids are distinct in that they allow shareholders to choose a minimum bid price from a range of prices set by the issuer, they are currently subject to the same legislative requirements as conventional issuer bids.

In this article, the author examines the origin of and policy behind the identical consideration and pro rata take-up requirements. The author argues that the current regulation of Dutch auctions contains a bias in favour of tendering shareholders and that the identical consideration and pro rata take-up requirements should not apply to these kinds of issuer bids. Omitting these requirements for Dutch auction issuer bids would allow equality of opportunity to be achieved. According to the author, this latter notion of equality constitutes the fairest result for both tendering and non-tendering shareholders in a Dutch auction issuer bid.

En vertu de la législation sur les valeurs mobilières actuellement en vigueur en Ontario, les offres ordinaires de l'émetteur sont simultanément sujettes à la règle de la «contrepartie identique» ainsi qu'à la règle de la «prise de livraison au prorata», lesquelles règles visent à assurer l'égalité de traitement pour les actionnaires déposants. Une variante de l'offre de l'émetteur ordinaire, connue sous le nom d'enchère au rabais (*Dutch auction*), acquiert depuis quelque temps au Canada une importante croissance en tant que mécanisme permettant aux émetteurs de racheter une partie de leurs actions émises. Bien que les offres de l'émetteur par enchère au rabais soient distinctes, étant donné qu'elles permettent aux actionnaires de choisir une offre minimale parmi une gamme de prix établie par l'émetteur, elles sont actuellement soumises aux mêmes règles législatives que les offres ordinaires de l'émetteur.

L'auteur, après avoir examiné l'origine des règles de la contrepartie identique et de la prise de livraison au prorata, ainsi que la politique qui les sous-tend, conclut qu'elles visent à établir une égalité de résultat dans le traitement des actionnaires qui déposent en réponse à une offre de l'émetteur. En outre, l'auteur soutient que la réglementation actuelle des enchères au rabais tend à favoriser les actionnaires déposants et que les règles de la contrepartie identique et de la prise de livraison au prorata ne devraient pas régir ce type d'offre de l'émetteur. Le fait de suspendre ces règles pour les offres de l'émetteur par enchère au rabais aurait l'effet de permettre l'établissement de l'égalité de traitement. Selon l'auteur, cette seconde notion d'égalité constitue le résultat le plus équitable, autant pour les actionnaires déposants que pour les actionnaires non-déposants, dans le contexte d'une offre de l'émetteur par enchère au rabais.

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Introduction

In a conventional issuer bid, the issuer announces a single price at which it will repurchase a stated number of validly tendered and accepted shares. The shareholder must simply decide how many shares, if any, he or she wishes to sell to the issuer. The issuer purchases the tendered shares and the bid is complete.

Recently in Canada, a variation of the conventional issuer bid has started to gain prominence as a mechanism of share acquisition used by issuers to repurchase a portion of their outstanding shares. Under a "Dutch auction" issuer bid, shareholders must choose a minimum price within a range of prices set by the issuer at which they would be willing to tender their shares. The issuer then selects the lowest price—often referred to as the "clearing price"—that enables it to repurchase the desired number of shares or to spend a pre-determined aggregate dollar amount on the bid. All shareholders who tender at or below the clearing price receive the clearing price in return for their shares.

At present in Ontario, the securities regulation which governs fixed-price and Dutch auction issuer bids is the same. Issuers must comply with Part XX of the *Ontario Securities Act*¹ which, among other things, requires that identical consideration be paid to those shareholders who tender to a bid.² In addition, issuers must repurchase shares on a "pro rata" basis which means that if more securities are tendered than the issuer wishes to purchase, the issuer must purchase the same percentage of shares from each tendering shareholder.³

In this article, I will argue that when completing in a Dutch auction, issuers should not be subject to the provision requiring payment of identical consideration. Securities regulators should distinguish between two types of equality: equality of opportunity and equality of result. In the case of the Dutch auction, securities regulation that ensures equality of opportunity alone is the fairest for all interested parties.⁴ I will contend that the present regulation contains a bias in favour of tendering shareholders and that this bias is ill-conceived. I will argue that any bias in issuer bid regulation

¹ R.S.O. 1990, c. S.5, as am. by S.O. 1992, c. 18, s. 56; S.O. 1993, c. 27, Sch.; S.O. 1994, c. 11, ss. 349-381; S.O. 1994, c. 33, ss. 1-9; S.O. 1997, c. 19, s. 23; S.O. 1997, c. 10, ss. 36-40; S.O. 1997, c. 43, Sch. F, s. 13; S.O. 1997, c. 31, s. 179 [hereinafter *OSA*].

² Section 97(1) of the *OSA* states "Subject to the regulations, where a take-over bid or issuer bid is made, all holders of the same class of securities shall be offered identical consideration."

³ Section 95(7) of the *OSA* states "Where the bid is made for less than all of the class of securities subject to the bid and where a greater number of securities is deposited pursuant thereto than the offeror is bound or willing to acquire under the bid, the securities shall be taken up and paid for by the offeror proportionately, disregarding fractions, according to the number of securities deposited by each depositing security holder."

⁴ In addition to tendering and non-tendering shareholders, other parties such as creditors, employees, and management also have an interest in the price paid by the corporation to repurchase its shares.

should be in favour of remaining shareholders who choose not to exit the corporation. Issuers completing a Dutch auction should be permitted to pay unequal consideration based on the prices chosen by those shareholders wishing to sell their shares. In such a case, the wealth transfer from non-tendering to tendering shareholders would be minimized.

I. The Dutch Auction

What is a "Dutch auction"? The term originates from a method of selling flowers which was developed by the Dutch in the 17th century. Merchants would set an initial price at which to sell their flowers and then lower it progressively until purchasers were found for the remaining stock. In the securities law context, a pure Dutch auction occurs when the issuer invites shareholders to tender their shares at prices specified by the shareholders. The issuer then proceeds to purchase shares, starting with those tendered at the lowest price and continuing with those tendered at increasing prices, until it has accepted all the shares it desires, purchasing shares at the varying prices at which they were tendered.⁵

The version of the Dutch auction that has gained prominence in both the United States and Canada as a method of share buyback is a modification of the pure Dutch auction. Under the modified version, the issuer specifies in advance the number of shares it wishes to purchase.⁶ Alternatively, the issuer specifies the aggregate dollar amount that it wishes to expend on the repurchase of shares under the offer.⁷ The issuer then establishes a range of prices within which shareholders can tender their shares for repurchase. Each tendering shareholder must choose the number of shares he or she wishes to sell and the lowest price which he or she will accept for the shares from the range of prices established by the issuer. Based on the prices selected by tendering shareholders and the maximum number of securities that the issuer wishes to repurchase (or the aggregate dollar amount that the issuer wishes to expend), a share purchase price, or "clearing price", is determined. The clearing price is the lowest price within the established price range which allows the issuer to purchase the maximum number of securities it wishes to buy or alternatively, to expend a pre-determined aggregate dollar amount. All securities tendered at or below the clearing price are taken up and paid for at the clearing price. Those securities tendered at

⁵ S.M. Piper, M.L. Berman & S.J. Notellovitz, "The Emerging Role of Dutch Auctions" *Insights* 3:8 (August 1989) 15 at 17.

⁶ Moore Corporation sought to purchase up to 12 million of its shares under a Dutch auction. See "Offer by Moore Corporation Limited to purchase for cash 12,000,000 of its common shares at a purchase price of not more than Cdn \$32.00 nor less than Cdn \$28.00 per share" (29 April 1997) 1 at 6. Genra Inc. sought to purchase five million of its common shares under a Dutch auction. See "Offer by Genra Inc. to purchase 5,000,000 of its common shares" (4 May 1999) 1 at 5.

⁷ For example, in Trimac's recent Dutch auction, the company announced the aggregate dollar amount to be \$65 million and also specified a maximum number of shares to be purchased. See Trimac, "Trimac Corporation Announces \$65 Million Issuer Bid", Press Release, Calgary (16 July 1998).

prices above the clearing price are returned to shareholders. Thus, the clearing price is determined according to the ascending order of shareholder bids until the specified number of shares or aggregate consideration is met.

The Dutch Auction is a popular method of share buy-back in the United States.⁸ This popularity originated in 1981 when the first Dutch auction was completed in the U.S. by Todd Shipyards.⁹ Between 1985 and 1988, Dutch auctions comprised 4% of all share repurchase programs and 43% of self-tender offers by exchange-listed companies in the United States. The Dutch auction is also becoming the transaction of choice for issuers wishing to complete a substantial issuer bid in Canada,¹⁰ where at least 10 Dutch auction issuer bids have been completed since 1996. These include bids by Imperial Oil and Métro Richelieu in 1996; Agrium, Cogeco, Moore Corporation, United Dominion Industries, and Shell Canada in 1997; Trimac in 1998; and both Manitoba Telecom Services and Gentra in 1999. All of these transactions took the form of the modified Dutch auction outlined above, such that each corporation specified a price range within which it would accept tenders and the number of securities or aggregate dollar amount that it wished to expend. A clearing price was then determined and paid to all shareholders who tendered at or below it.¹¹

The Dutch auction is appealing to issuers for a number of reasons. First, rather than attempting to isolate a per share price which may ultimately result in the over- or under-valuing of its shares, the issuer relies on the company's shareholders to value its stock. While many issuers will have a valuation completed,¹² such valuations are often inaccurate or unsatisfactory, as the Ontario Securities Commission ("OSC") itself has

⁸ G.D. Gay, J.R. Kale & T.H. Noe, "(Dutch) Auction Share Repurchases" (1996) 63 *Economica* 57.

⁹ In a circular dated September 22, 1981, Todd Shipyards offered to repurchase up to 550,000 of its own shares. Shareholders were given the opportunity to specify a price between \$21 to \$28 per share at which they would be willing to tender. Todd agreed that it would pay each shareholder identical consideration for their shares, in an amount not exceeding \$28. The offer specified that a minimum number of shares be purchased; that minimum number would be 200,000 shares. Todd stated that it would determine the clearing price by taking into account the number of shares tendered and the prices at which they were tendered. The clearing price was left to Todd's discretion except to the extent that Todd would be required to pay \$28 per share in order to purchase the 200,000 minimum number of shares. After the expiry date, Todd announced that it had set a clearing price of \$26.50 and that approximately 208,000 shares had been tendered at prices at or below \$26.50. Todd then offered to accept up to an additional 342,000 shares at \$26.50 per share until a specified date. Thereafter, the bid closed and Todd announced that it had purchased a total of 397,825 shares which had been tendered at or below a price of \$26.50. See L. Lederman & P. Vlahakis, "Pricing and Proration in Tender Offers" *Review of Securities Regulation* 14:20 (18 November 1981) 813 at 814.

¹⁰ A distinction is drawn in securities legislation and in stock exchange bylaws between "normal course issuer bids" and "substantial issuer bids". The Dutch auction is a type of substantial issuer bid.

¹¹ For the remainder of this article, the modified Dutch auction will be referred to simply as a "Dutch auction."

¹² If Ontario Securities Commission Policy 9.1 (presently being reformulated as Rule 61-501. See *infra* note 13) applies to the bid, an independent valuer must prepare a formal valuation of the issuer and subject securities.

noted.¹³ Second, if the issuer sets the appropriate price range, it is likely to pay less in aggregate than it would in a fixed-price issuer bid. The stock is less likely to be overvalued and the issuer pays only what the market dictates. This is advantageous to the issuer and non-tendering shareholders alike, primarily because the transfer of wealth from non-tendering to tendering shareholders is minimized. Finally, Dutch auctions tend to reduce the premiums paid to arbitrageurs.¹⁴ Because arbitrageurs are unaware of the ultimate price which will be paid to shareholders (*i.e.* the clearing price), they face greater risk and may be less willing to bid up the price of the security.

II. Relevant History

A. *Establishing the Right of a Company to Purchase Its Own Shares*

The starting point for a discussion about the legality of a corporation purchasing its own shares is the 1887 case of *Trevor v. Whitworth*.¹⁵ In that case, the articles of the corporation permitted the corporation to repurchase its shares. When a shareholder of the corporation whose shares were not fully paid up applied to have his shares repurchased by the corporation, the House of Lords held that such a repurchase was impermissible¹⁶ because, in addition to violating the applicable statute, buying back shares would serve to withdraw capital from the asset base of the corporation. In addition, allowing the corporation to repurchase its own shares was found not to be in the best interests of the corporation's creditors.

Trevor v. Whitworth was distinguished by the Supreme Court of Canada in *Hughes v. Northern Electric and Manufacturing*.¹⁷ In that case, the shareholders of Northern Electric and Manufacturing were unable to agree upon the management of the corporation. They created a strategy whereby the corporation was to mortgage its assets in order to allow dissenting shareholders to be bought out by other shareholders with the result that the corporation would continue debt-free. The Supreme Court of Canada allowed this restructuring on the basis that allowing the corporation to operate debt-free would ensure the greatest protection of creditors' interests.

¹³ "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 at 2990. The OSC has revised the rules relating to valuations in an issuer bid. These rules have been disseminated for comment. See "Notice of Proposed Changes to Proposed Rule 61-501 and Proposed Companion Policy 61-501CP under the *Securities Act*—Insider Bids, Issuer Bids, Going Private Transactions and Related Party Transactions", online: Ontario Securities Commission Homepage <http://www.osc.gov.on.ca/en/Regulation/Rulemaking/Rules/61-501_r_cp.html> (date accessed: 18 January 2000). See also A.I. Anand, "Fairness at What Price? An Analysis of the Regulation of Going-Private Transactions in OSC Policy 9.1" (1998) 43 McGill L.J. 115 at 131.

¹⁴ Piper, Berman & Notellovitz, *supra* note 5 at 17.

¹⁵ (1887) 12 App. Cas. 409 (H.L.).

¹⁶ *Ibid.* at 423.

¹⁷ (1915), 50 S.C.R. 626, 21 D.L.R. 358.

Trevor v. Whitworth laid down the fundamental principle that it is unlawful for a company to purchase its own shares. Yet, following the Supreme Court's decision in *Hughes v. Northern Electric and Manufacturing*, it became clear that courts were not willing to support the rigidity of the rule in *Trevor v. Whitworth* if the result appeared disadvantageous to creditors. Subsequent case law followed this approach.¹⁸ In 1962, the *Report of the Company Law Committee* recommended that English companies should not be entitled to purchase their own shares.¹⁹ The Committee relied on *Trevor v. Whitworth* but did not explicitly explain the rationale underlying its recommendation. It appears that the Committee shared the concern of the courts in the above-noted cases and sought to protect creditors from default risk. However, the Committee's recommendation seems odd in light of the fact that it approved of the American practice of allowing companies to repurchase their own shares. The Committee noted that such a practice had not led to "abuse and it [was] useful for a number of purposes."²⁰ Nevertheless, the Committee refused to deviate from the principle laid down in *Trevor v. Whitworth*.

The 1965 *Report of the Attorney-General's Committee on Securities Legislation in Ontario*²¹ widely supported the recommendations in the *Jenkins Report*, though it did not reopen the discussion concerning share repurchases. Two recommendations outlined in the report related to the pro rata and equal consideration rules. The Committee endorsed acceptances by the offeror on a pro rata basis.²² The Committee also recommended that "an offeror who increases the price of his offer... be required to pay the increased consideration to accepting shareholders whether or not he has, prior to the increase, taken up and paid for shares deposited under the offer."²³ The recommendation regarding pro rata acceptances was embodied in *The Securities Act, 1966*.²⁴ However, the Act did not endorse the notion that consideration for accepting shareholders in an issuer bid must be identical. The recommendations contained in the *Kimber Report* related specifically to takeover bids.²⁵ There is no reason to assume that they were intended to apply to issuer bids since, at the time of the *Kimber Report*, issuer bids were not permitted in the Province of Ontario.

¹⁸ See *Helwig v. Siemon* (1916), 10 O.W.N. 296 (Ont. Div. Ct.) in which the Ontario Divisional Court held that the company at issue had no power to repurchase its own shares or to bind itself to resell them. See also *Alberta Rolling Mills v. Christie* (1919), 58 S.C.R. 208 at 221, 45 D.L.R. 545 at 554 and *Zwicker v. Stanbury* [1953] 2 S.C.R. 438 at 440, [1954] 1 D.L.R. 257 at 270.

¹⁹ *Report of the Company Law Committee* (London: Her Majesty's Stationery Office, 1962) at paras. 167-168 [hereinafter *Jenkins Report*].

²⁰ *Ibid.* at para. 167. One of these purposes was that a company could provide employees with shares as part of a bonus plan and would increase its own shares by repurchasing such shares.

²¹ (Toronto: Queen's Printer, March 1965) [hereinafter *Kimber Report*].

²² *Ibid.* at para. 3.15.

²³ *Ibid.* at para. 3.22.

²⁴ S.O. 1966, c. 142, s. 81(7) [hereinafter *1966 Securities Act*].

²⁵ See, for instance, Part III of the *Kimber Report* entitled "Take-over Bids".

In 1967, a recommendation came forward in Ontario for the rule in *Trevor v. Whitworth* to be abolished and for provisions to be enacted which would enable companies to repurchase their own shares. The Select Committee on Company Law pointed out a number of useful reasons for a company to purchase its own shares: to establish bonus or stock option plans without having to extend its equity base to provide the required shares, to contract its equity base according to the financial requirements of the company, to facilitate mergers and acquisitions and to provide flexibility in the event of the death or retirement from the business of a principal shareholder.²⁶ Accordingly, the *Lawrence Report* proposed that, subject to restrictions set forth in a company's charter, a company should be permitted to repurchase its common shares unless the company is insolvent or would be rendered insolvent as a result of the repurchase.²⁷

The *Business Corporations Act, 1970*²⁸ echoed the recommendations of the *Lawrence Report* by allowing a corporation to purchase its own common shares out of surplus and, in limited circumstances, out of issued capital. The legislation stipulated that share repurchases be made on a pro rata basis from bona fide or former employees of the corporation or, alternatively, by purchase on the open market if the corporation had offered its shares for public auction.²⁹ In addition, the *BCA 1970* compelled corporations to cancel the repurchased shares only if the articles of the corporation stipulated such cancellation.³⁰ The *Business Corporations Amendment Act, 1971*³¹ slightly modified the *BCA 1970*, by stating:

Where a corporation purchases its common shares ... the purchase shall be made at the lowest price at which, in the opinion of the directors, such shares are obtainable, and ... pursuant to tenders received by the corporation upon request for tenders addressed to all the holders of the shares of the class and the corporation shall accept only the lowest tenders ...³²

This provision is significant because it expressly allowed for Dutch auction-style issuer bids in Ontario.³³

In 1977, the OSC introduced Policy 3-37 under which it expressly permitted issuer bids for the first time.³⁴ In the preamble to the policy, the OSC acknowledged that

²⁶ Ontario, Legislative Assembly, "1967 Interim Report of the Select Committee on Company Law" *Sessional Papers* (1967) at para. 5.2.8. [hereinafter *Lawrence Report*].

²⁷ *Ibid.* at para. 5.2.9.

²⁸ S.O. 1970, c. 25, s. 39 [hereinafter *BCA 1970*]. Prior to the *BCA 1970*, corporations were permitted only to repurchase their own preference shares for cancellation, conversion or redemption. See the *Corporations Act*, R.S.O. 1960, c. 71, s. 27.

²⁹ *BCA 1970, ibid.*, s. 39(5).

³⁰ *Ibid.*, s. 40.

³¹ S.O. 1971, c. 26, s. 9.

³² *Ibid.*

³³ This amendment to the *BCA 1970* was repealed in 1982. See *Business Corporations Act, 1982*, S.O. 1982, c. 4, s. 277.

these bids were already permitted under corporate statutes, but stated its concern that such legislation generally did not contain provisions which required disclosure of information to shareholders. Thus, Policy 3-37 compelled timely disclosure of certain information if the issuer did not fall within certain stated exceptions³⁵ and required the issuer to obtain an independent valuation in certain instances.³⁶ In subsequent amendments to Policy 3-37,³⁷ the OSC stated that, in addition to applying to issuer bids, the requirements contained in the policy applied to a take-over bid made by any insider of the issuer or any associate or affiliate of the insider.³⁸

One year later, issuer bids came to be regulated with takeover bids in Part XIX of the *1978 Ontario Securities Act, 1978*.³⁹ Thus, corporations wishing to complete an issuer bid now had to comply with a number of provisions which had previously applied only to corporations pursuing a take-over bid. These provisions addressed minimum bid periods,⁴⁰ the granting of withdrawal rights⁴¹ and the pro rata take-up of shares when the number of shares tendered to the bid exceeded the number sought by the issuer.⁴²

B. The Identical Consideration Provision

The *1978 Securities Act* also contained a provision requiring issuers to pay identical consideration to all shareholders who tendered to a bid. This provision read: “[w]here, during the course of a take-over bid or an issuer bid, the offeror pays or agrees to pay a price for securities higher than the consideration offered through the take-over bid or issuer bid, the take-over bid or issuer bid shall be deemed to be varied

³⁴ “Issuer Bid—An offer by an issuer to purchase, redeem or retire its own securities: timely disclosure” Ontario Policy No. 3-37 (1977) O.S.C.B. 253; 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 (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.

³⁵ Policy 3-37 (1977) O.S.C.B. 253 at 257 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 any appraisal or valuation known to the directors or officers of the issuer, regarding the issuer, its material assets or securities ... within the two years preceding the date of the bid.”

³⁶ *Ibid.* at 262, para. 20(b).

³⁷ “Statement of Commission Policy—Notice Regarding Policy 3-37” (1977) O.S.C.B. 273.

³⁸ 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.

³⁹ S.O. 1978, c. 47 [hereinafter *1978 Securities Act*]. See also Bill 7, *An Act to Revise the Securities Act*, 2d. Sess., 31st Leg., Ontario, 1978, cl. 27.

⁴⁰ *OSA*, *supra* note 1, s. 95(2).

⁴¹ *Ibid.*, s. 95(4).

⁴² *Ibid.*, s. 95(7).

by increasing the consideration to the higher price.”⁴³ The rationale underlying this provision was not stated in the 1978 legislation, nor was it stated in the *Kimber Report* which originally proposed the inclusion of such a provision. However, a report prepared in 1983 for the OSC, known as the *Practitioner Report*, stated:

Shareholders of an...issuer and public investors generally should be confident that transactions which may affect the de facto control of public security issuers will be made, as a matter of principle, on a basis which requires *identical treatment* of holders of the same class of securities and that all such shareholders will have an equal opportunity to participate in the benefits which may accompany a change of effective control of public issuers.⁴⁴

The *Practitioner Report* appears to be the first public document in which the notion of “equal opportunity” was used. It was thought that an identical consideration provision was an important element in ensuring that shareholders had equal opportunity to share in the benefits of “change in control” transactions. According to this conception of equal treatment, treating shareholders equally means treating them identically.

The concern of the Practitioner Committee to ensure the equal treatment of shareholders stemmed in part from existing controversy surrounding the “private agreement” exemption.⁴⁵ In its original formulation, this provision exempted from the take-over bid rules offers “to purchase shares by way of private agreement with individual shareholders ... not made to shareholders generally.”⁴⁶ However, the *Securities Amendment Act, 1971* defined an “exempt offer” more narrowly as “an offer to purchase shares by way of private agreement with fewer than 15 shareholders and not made to shareholders generally.”⁴⁷ Subsequently, a requirement was added that a purchaser acquiring securities pursuant to the private agreement exemption at a price greater than 115% of the market price make a “follow-up offer” to the remaining shareholders of the offeree issuer at a consideration equal to that paid under the private agreement.⁴⁸ The possibility of issuers having the opportunity to purchase shares in an issuer bid at differing prices, however, was not contemplated by the Practitioner Committee.

In commenting on the private agreement exemption, the *Practitioner Report* stated its concern that the exemption could become an avenue for control-block security-holders to realize premiums for control which were not available to minority

⁴³ *Supra* note 39, s. 89(14)(3).

⁴⁴ J.G. Coleman, H.G. Emerson and D.A. Jackson, “Report of the Committee to Review the Provisions of the Securities Act (Ontario) Relating to Take-over Bids and Issuer Bids” (23 September 1983) at 1 [emphasis added, hereinafter *Practitioner Report*].

⁴⁵ *Ibid.*, paras. 5.01 and 5.02. For a history of the development of the private agreement exemption, see B. Bailey & P. Crawford, “The Take-Over Bid by Private Agreement: The Follow-Up Offer Obligation” (1983) Dal. L.J. 93. See also R.J. Daniels & J.G. MacIntosh, “Toward a Distinctive Canadian Corporate Law Regime” (1991) 29 Osgoode Hall L.J. 863 at 900.

⁴⁶ *1966 Securities Act*, *supra* note 24, s. 80(b)(i).

⁴⁷ S.O. 1971, c. 31, s. 22(b)(i).

⁴⁸ Coleman, Emerson & Jackson, *supra* note 44, para. 5.01.

shareholders.⁴⁹ The OSC shared the concern of the *Practitioner Report*, as evidenced in the following year when the Commission reviewed a cash offer made by Color Tile to all shareholders of Color Your World. Color Tile offered shareholders \$26 per share, other than one shareholder whose shares were to be acquired at \$17 per share. Color Tile represented that the shareholder agreeing to accept \$17 per share had entered into an agreement with persons controlling Color Your World which provided for the receipt by him of lower consideration. At the time, the shareholder was aware of Color Tile's interest in making an offer to all shareholders at a higher price. The OSC allowed Color Tile to deviate from the identical consideration provision, but issued a statement which emphasized that such deviation would not be permitted as a matter of course:

The Commission is aware that permitting a security holder to accept less than the consideration offered to other security holders may be perceived as creating an opportunity for significant shareholders of public companies, in effect, to increase the net consideration payable to themselves by obliging other security holders to accept a lesser consideration. The Commission would consider such an arrangement as contrary to the provisions of the section.⁵⁰

The Commission was thus of the view that the identical consideration provision could be a means of preventing controlling shareholders from receiving greater consideration than other shareholders in the context of a take-over bid. Significantly, the concern of the Commission was to ensure the identical treatment of shareholders in a take-over bid, but not in an issuer bid.

The rationale underlying the identical consideration provision was further discussed in the case of *CDC Life Sciences, Caisse de Depot et Placement du Quebec, and Institut Merieux S.A.*⁵¹ The case dealt with a joint hearing of the OSC and the Commission des valeurs mobilières du Québec which considered certain alleged irregularities in a take-over bid by Institut Merieux for up to 4,369,000 of CDC Life Sciences' common shares. Merieux and the Caisse had entered into an agreement that was collateral to the bid. The OSC was asked to determine whether the agreement had the effect of providing the Caisse with a consideration of greater value than that which had been offered to other shareholders of CDC common shares.

Philip Anisman, as counsel to shareholders Allinvest Group and the Ontario Hydro Pension Fund, made a request for a cease trade order of CDC Life Sciences' common shares. Mr. Anisman noted that there were two policies underlying the identical consideration provision. Echoing the *Practitioner Report*, he asserted that the provision ensured that all shareholders would have an equal opportunity to accept the bid on the basis of full disclosure relating to the bid, the offeror and the target company. Second, Anisman argued that the provision ensured that the holders of publicly-traded securities would be treated equally by those who purchased a large block of se-

⁴⁹ *Ibid.*, para. 5.04.

⁵⁰ (1984) 7 O.S.C.B. 777.

⁵¹ (1988) 11 O.S.C.B. 2541 [hereinafter *Institut Merieux*].

curities from a controlling shareholder.⁵² The OSC seemed to agree with this interpretation of the purposes of the identical consideration provision, although it did not explicitly endorse it.⁵³ Ultimately, the OSC held that the Merieux-Caisse agreement offended the principle requiring identical treatment of shareholders.⁵⁴

A review of the history of the identical consideration provision indicates that there has been little deliberate reflection and discussion by regulators about whether the provision should apply to issuer bids, or particularly, to Dutch auction issuer bids. It appears as though issuer bids were grouped in with takeover bids, despite the fact that these transactions involve very different methods of share acquisition. In a takeover bid, there may be sound reasons for compelling compliance with the identical consideration provision such as those discussed in *Institut Merieux*. However, it is questionable whether such reasons apply in the issuer bid context, especially when one considers the position of shareholders who do not tender to the issuer bid.

C. The Principle of Equality in Corporate and Securities Law

The principle of equal treatment of shareholders is central to both securities and corporate law.⁵⁵ A historical presumption relating to shares of a corporation is that the rights of shareholders are equal in all respects.⁵⁶ This principle of equality among

⁵² For a discussion of this point, see L. Sarna, *Mergers and Acquisitions* (Montreal: Jewel, 1994) at I.50.

⁵³ *Ibid.* at I.51.

⁵⁴ (1988) 14 O.S.C.B. at 3647. In limited instances, the OSC has exempted issuers from the identical consideration provision. In a case involving Husky Oil (*Husky Oil* (1988), 11 O.S.C.B. 3647, in L. Sarna & P. Alince, *Mergers and Acquisitions* (Montreal: Jewel, 1989) vol. 1 at para. 2.8), the OSC heard an application for an order exempting Husky Oil from the identical consideration provision with respect to a proposed take-over bid for all of the outstanding common shares of Canterra Energy. Nova of Alberta held approximately 12.2 per cent of Canterra's shares and 43 per cent of Husky's outstanding shares. Pursuant to an agreement, Nova was to indirectly acquire approximately 51 per cent of Canterra's shares. This was done by the acquisition by Husky of the outstanding common shares of Polysar Energy and Chemical Corp. ("PECC") from Nova and the general public. This agreement was made on the basis that certain PECC shareholders would be able to sell their shares for at least \$3.00 per share. Husky subsequently agreed to purchase the shares beneficially owned by Nova for \$2.78 and all publicly owned shares for not less than \$3.00. The OSC exempted Husky from paying identical consideration to all Canterra shareholders, allowing Husky to pay the lesser price to Nova and the higher price to the public.

⁵⁵ For the purposes of this paper, I discuss corporate law principles as being distinct from securities law principles. However, it is recognized that in many respects, there is no clear line dividing these subjects. See P. Anisman, "Regulation of Public Corporations: The Boundaries of Corporate and Securities Law" in *The Future of Corporation Law: Issues and Perspectives, Papers Presented at the Queen's Annual Business Law Symposium 1997* (Scarborough: Carswell, 1999) 63 at 63.

⁵⁶ See *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, ss. 24(3), 24(4) [hereinafter *CBCA*].

shareholders has been enunciated in numerous cases,⁵⁷ including the relatively recent case of *R. v. McClurg*.⁵⁸ Over the years, the presumption of equality between shareholders has been modified; a principle of equality of rights applies to shares within a class of shares but no such principle applies as between classes of shares.⁵⁹

In *McClurg*, the issue under consideration was the proper allocation of dividends by the corporation among differing classes of shares. The Minister of National Revenue argued that there was a duty to allocate dividends equally among all classes of common shares regardless of class or any other express conditions attached to the shares. The Supreme Court of Canada held that the prima facie presumption of equality was still valid. The Court cited *Palmer's Company Law* which states that "[p]rima facie the rights carried by the shares rank *pari passu*, i.e. the shareholders participate in the benefits of membership equally."⁶⁰ Another important aspect of the Court's decision lay in its confirmation that the right to equality attaches to the share and not the shareholder. The Court held that this principle justifies the derogation from the principle of equality with respect to the division of shares into separate classes.

In addition to its prevalence at common law, the principle of equality of shareholders also underlies the *OSA*, particularly the legislation's issuer bid and take-over provisions.⁶¹ As Anisman notes, the policy underlying the take-over bid provisions of the *OSA* calls for the equal treatment of shareholders of the offeree.⁶² This principle includes the right of such shareholders to have equal opportunity to make a rational decision about a take-over bid on the basis of all relevant information. As Anisman explains:

The Commission has characterized this principle [of equal treatment] as "paramount." It is declared expressly in the Act and it pervades Part XIX [now Part XX]; it underlies the limitations on private agreements, prebid and postbid transactions and purchases by an offeror during the course of a take-over bid, as well as the prohibition against collateral agreements between an offeror and a security holder of a target corporation. ... The equal treatment principle has informed most of the Commission's decisions on takeover bids under the new provisions of the Act.⁶³

⁵⁷ *Gray v. Portland Bank* (1807), 3 Am. Dec. 156; *Birch v. Cropper*, [1889] 14 App. Cas. 525 (H.L.); *North-West Electric v. Walsh*, [1899] 29 S.C.R. 33, 11 Man. R. 629; *International Power v. McMaster University*, [1946] S.C.R. 178, 2 D.L.R. 81; *Bowater Canadian v. R.L. Crain Inc.* (1987), 62 O.R. (2d) 752, 46 D.L.R. (4th) 161 (H.C.J.) [hereinafter *Bowater Canadian* cited to O.R.].

⁵⁸ [1990] 3 S.C.R. 1020, 76 D.L.R. (4th) 217 [hereinafter *McClurg* cited to S.C.R.].

⁵⁹ See e.g. *McClurg*, *ibid.*; *Bowater Canadian*, *supra* note 57.

⁶⁰ *McClurg*, *supra* note 58 at 1041, citing C.M. Schmitthoff, ed., *Palmer's Company Law*, 23d ed., vol. 1 (London: Stevens & Sons, 1982) at 387.

⁶¹ *Supra* note 1, Part XX.

⁶² P. Anisman, "The Commission as Protector of Minority Shareholders" *Special Lectures of the Law Society of Upper Canada: Securities Law in the Modern Financial Marketplace* (Toronto: De Boo, 1989) 451 at 482.

⁶³ *Ibid.* at 482-83.

In analyzing the principle of equal treatment, it should not be assumed that one precise meaning of "equality" exists which is readily applicable in all circumstances. In other areas of law, particularly human rights law, a distinction is drawn between two concepts of equality. "Equality of opportunity" seeks to ensure that individuals have the same rights of access to advantaged positions and resources, but does not guarantee any particular outcome for these individuals. "Equality of result" seeks to ensure that disadvantaged persons or groups end up with equal shares of the particular good being allocated.⁶⁴

The regulation of issuer bids is premised on the view that, unless shareholders receive identical consideration, they are not treated equally. However, it is submitted that as long as shareholders have an equal opportunity to participate in the transaction, they are indeed being treated equally. Shareholders are treated equally if they have an equal opportunity to participate and if the rules of the game are stated clearly in disclosure documents which are circulated to all shareholders.

The Supreme Court's holding in *McClurg* and particularly, its reference to *Palmer's Company Law* are consistent with an "equality of opportunity" concept. Shareholders are entitled to participate equally in the benefits of membership in a corporation. It is their rights as shareholders which are identical and not necessarily the consideration paid to them in a given transaction. If shareholders are given equal opportunity to participate in a transaction, they are accorded the same benefits of ownership. A prime example of the principle of equal opportunity presently exists in structuring take-over bid transactions. It is common for an acquirer to offer cash or shares (or a combination of both) to target shareholders. Shareholders are able to choose the form of consideration they wish to receive and, as such, are treated equally, though not identically.

It is a contention of this paper that securities regulation needs to be refined in order to account for differing conceptions of equality. In particular, the principal of equality should not automatically be interpreted to mean equality of result. As will be argued below, regulators can ensure that shareholders have an equal opportunity to participate in a transaction without necessarily ensuring that they all benefit in an identical manner from the transaction.

III. Identical Treatment

Issuers wishing to complete a Dutch auction typically apply to securities commissions for an exemption from the proportionate take-up provision of the applicable securities legislation. An exemption is required because issuers offer to purchase at the clearing price the entire block of shares of holders of "odd lots".⁶⁵ In addition, some issuers choose to allow shareholders to make a "proportionate tender" so that the

⁶⁴ See M. Rosenfeld, *Affirmative Action and Justice* (New Haven: Yale University Press, 1991) at 16 for a discussion of these principles.

⁶⁵ In Canadian Dutch auctions, the odd lot number is typically 100 shares.

holder can maintain his or her proportionate interest in the company.⁶⁶ Securities regulatory authorities grant the exemption and the issuer may begin the process of buying back its shares. No exemption is needed from the identical consideration provision because companies typically agree to establish a clearing price which results in all tendering shareholders receiving identical consideration.

In the case of a conventional issuer bid, a requirement that issuers treat shareholders identically seems justified. It is the issuer that is choosing the purchase price. The only choice facing the shareholder is whether to tender *at that price* or not. The possibility of unfair treatment typically arises when the issuer is not satisfied with the number of shares tendered at a certain price. The issuer may then raise the purchase price as an incentive for other shareholders to tender. The issuer is obliged under the identical consideration provision to provide all shareholders with the higher price, regardless of the price at which each shareholder originally tendered.

Application of the identical consideration provision in this case is justified because the shareholders who tendered at the initial price were unaware that a higher price would be offered. If they had known that the price would be raised, they might not have tendered. It would be unfair to penalize them for a subsequent decision by the issuer to increase the price. As Anisman argues, a principle of equality of treatment among offerees is desirable because:

Offerees who accept an offer before the price is increased irrevocably deposit their shares without the offeror having unconditionally committed himself to buying them and as a result of their deposit do not have an opportunity to take advantage of the increase in price. As the offeror benefits from the fact that the deposit is irrevocable it seems fair that he, in return, pay all shareholders the same amount where he increases the price.⁶⁷

By contrast, in the Dutch auction, shareholders are aware at the outset of the range of prices being offered by the issuer. They know that if they tender at a low price, their shares are more likely to be purchased than if they tender at a higher price within the pre-determined range. There is no possibility of unfair treatment since shareholders have actually chosen the price at which they are willing to tender within

⁶⁶ These types of tenders are sometimes referred to as "purchase price tenders". Under this type of tender, a shareholder tenders all beneficially-owned securities and thereby elects to have the issuer purchase that number of securities necessary to maintain the holder's proportionate ownership in the company. The shareholder does not specify a price at which his or her securities may be purchased by the issuer. Rather, the shareholder must be willing to accept the clearing price set by the issuer once all tenders have been received. For example, Dutch auctions completed by Imperial Oil (1996) and Shell (1997) allowed shareholders to tender bids by way of proportionate, or purchase price, tenders. See "Offer by Imperial Oil Limited to purchase for cash 24,000,000 of its common shares at a purchase price not in excess of Cdn \$61.00 nor less than Cdn \$53.00 per share" (28 July 1996) and "Offer by Shell Canada Ltd. to purchase for cash 16,000,000 of its class A common shares at a purchase price not in excess of Cdn \$61.00 nor less than Cdn \$53.00 per share" (5 May 1997).

⁶⁷ P. Anisman, *Takeover Bid Legislation in Canada: A Comparative Analysis* (Don Mills, Ont.: CCH Canadian, 1974) at 90-91.

the range specified by the issuer.⁶⁸ Disclosure requirements in securities regulation support the argument that shareholders are treated equally and fairly since all of the particulars of the bid are disclosed in the circular which is sent to shareholders.

A common criticism of this argument deserves mention. Some critics contend that shareholders do not read information contained in disclosure documents. Therefore, they require further protection in the legislation governing acquisition transactions. An identical treatment provision is appealing because it is difficult for participating shareholders to claim that they have been treated unfairly if they have been treated identically. But to what extent must an issuer "hold the hands" of its shareholders? How far does an issuer have to go to ensure that shareholders to whom a bid is directed are aware of the terms of the bid? It is submitted that an issuer which has clearly and concisely outlined the terms of the bid in a circular, including all relevant information regarding the value of the shares, and mailed this circular to its shareholders has discharged its responsibility to shareholders. Whether shareholders choose to review the information and understand the terms of the bid is a matter outside of the issuer's duties.

I contend that issuers should be permitted to repurchase shares at prices chosen by shareholders within a range of prices specified by the issuer in a Dutch auction. In fact, as it will now be argued, it would be fairest to all interested parties if the shares were purchased at the prices chosen by tendering shareholders. All shareholders would have an equal opportunity to participate in the transaction and in this sense would be treated equally, though not identically.

IV. Policy Implications

In practical terms, the argument in favour of equal opportunity would mean that issuers completing a Dutch auction would not be bound by the identical consideration provision. Yet the question arises as to whether it would be fair in practice if issuers were permitted to purchase shares at differing prices within a range previously specified by the issuer through the use of a Dutch auction. In responding to this question, the differing interests of exiting shareholders and remaining shareholders must be taken into account. These groups of shareholders may, in some circumstances, consist of minority and/or controlling shareholders as well as retail or institutional shareholders. In addition, one must consider the implications of the current proposal in favour of equal opportunity on the pro rata take-up rule.

⁶⁸ The purchase and sale of shares in a Dutch auction are analogous to purchase and sale of shares on the secondary market. On any particular day, shareholders on the secondary market buy and sell shares at a number of different prices. Although every shareholder would prefer to sell at the highest price at which shares traded on the day they sell shares, there is nothing unfair about the fact that some sellers receive higher prices than others since every market participant is a willing participant. In the Dutch auction, as in the open market, shareholders are provided with the choice of whether to sell or not to sell and, if they decide to sell, at what price.

A. *Exiting Shareholders versus Remaining Shareholders*

At present, the regulation of issuer bids, including Dutch auctions, contains a bias in favour of shareholders whose shares are purchased by the issuer ("exiting shareholders"). Take for example a Dutch auction transaction in which the issuer specifies a price range between \$20 and \$25 and Shareholders X, Y and Z tender at the prices of \$21, \$22 and \$23 respectively. The clearing price is \$23 so Shareholders X, Y and Z each receive \$23 for their shares. But what about Shareholders P and Q who tendered at \$24 and \$25 respectively and Shareholder R who did not tender to the bid at all? The interests of Shareholders P, Q and R seem not to be considered. Even though these shareholders do not participate in the transaction, they are nevertheless affected by its outcome. Their wealth is affected because, as remaining shareholders in the company, they ultimately bear the cost of the issuer's share repurchase.⁶⁹

If issuers specify a range of prices and are then permitted to purchase shares at prices selected by tendering shareholders, they will first purchase shares tendered at the lowest prices. The transaction is "fair" for exiting shareholders since they are willing participants and all relevant aspects of the transaction have been disclosed to them. Shareholders who do not tender to the bid (or tender only a portion of their holdings) are better off because the dollar amount that the issuer has spent on the bid is lower than it would be had the issuer paid all tendering shareholders identical consideration.⁷⁰ Under the scheme proposed in this article, there is no possibility that the issuer will "overpay" or, in other words, establish a clearing price above that required to acquire the desired number of shares.⁷¹

It may be argued that remaining shareholders are not treated unfairly under the current regulation since they have an equal opportunity to sell their shares during the bid. There appears to be no need or reason therefore to revise the regulation of Dutch auction issuer bids in favour of remaining shareholders. However, there are several factors which may deter remaining shareholders from tendering their shares. These

⁶⁹ Gay, Kale & Noe, *supra* note 8 at 59.

⁷⁰ Consider also that in some bids, many of the tendering shareholders are arbitrageurs, or "quick buck artists", who subsequently dump whatever shares are not purchased by the company. See James J. Cramer, "Spot a Dutch Auction and Find Stock Value" *Legal Times* (4 September 1989) 22.

⁷¹ Indeed, this is an argument made in favour of Dutch auctions generally. As stated in one application submitted to the OSC:

[O]verpayment results in excessive payments to tendering shareholders, essentially a transfer of wealth from non-tendering to tendering shareholders. It is this overpayment factor that causes some fixed price offers to become coercive—shareholders are forced to tender to ensure participation in proportion to their ownership interest and avoid transferring wealth to tendering shareholders ("Re: Application of Agrium Inc. Pursuant to Clause 104(2)(c) of the *Securities Act* (Ontario) to the OSC" (17 December 1996) Appendix A at 3).

If, on the other hand, issuers were permitted to repurchase shares at prices chosen by tendering shareholders, the cost of the transaction would be less than under the current regulation since some shareholders would receive less than the would-be "clearing price".

factors include reinvestment opportunities and transaction costs as well as the tax implications that selling shares may have for certain shareholders. In particular, it may be difficult or costly for shareholders to identify an investment opportunity which is comparable to that presented by the issuer. In addition, shareholders who are individuals and who hold shares of the issuer outside an RRSP may face capital gains tax upon the sale of their shares to the issuer under the bid. For these reasons, many shareholders may choose not to tender to the issuer bid despite the transfer of wealth to tendering shareholders.

It could also be contended that the interests of remaining shareholders are protected since directors are obligated under corporate statute to act in the "best interests of the corporation."⁷² There is no need to protect the interests of remaining shareholders in securities regulation as well. On this argument, it is justifiable for securities regulation to favour exiting shareholders since their interests are directly opposed to those of remaining shareholders whose interests are protected under corporate statute.

This argument assumes that the directors' duty to the corporation includes a duty to remaining shareholders.⁷³ However, it is not certain that the interests of shareholders—whether they are remaining or exiting shareholders—are protected under the directors' corporate law obligation. Case law in Canada has firmly established that a director's duty under corporate law is owed to the corporation, not to the shareholders of the corporation.⁷⁴ In addition, as Professor Welling *et al.* have stated, "There are several ways a legal analyst could interpret the requirement that a director or manager act 'with a view to the best interests of the corporation.'"⁷⁵ At the very least, one must accept that in law, the corporation is its own person.⁷⁶ In considering what is in the best interests of the corporation, the shareholders are only one of various groups whose interests must be taken into account. In addition to shareholders, employees, creditors, members of the community and, in some cases, government can claim to have an interest of some sort in the corporation.⁷⁷ To say that remaining shareholders are protected by virtue of the corporate duty of directors to act in the best interests of the corporation overlooks this fact.

⁷² *BCBA*, *supra* note 56, s. 122(1)(a); *Business Corporations Act*, R.S.O. 1990, c. B.16, s. 134(1)(a) [hereinafter *OBCA*].

⁷³ The argument also highlights the importance for the corporation of seeking to repurchase its shares at the lowest aggregate price possible since its directors have an explicit duty to act in the best interests of the corporation.

⁷⁴ See *Regal Hastings v. Gulliver*, [1942] 1 All E.R. 378 (H.L.); *Abbey Glen Property v. Stumborg* (1978), 85 D.L.R. (3d) 35, [1978] 4 W.W.R. 28 (Alta. S.C. (A.D.)); *Teck Corp. v. Millar*, [1973] 33 D.L.R. (3d) 288, [1973] 2 W.W.R. 385 (B.C.S.C.); *Western Finance v. Tasker Enterprises* (1979), 1 Man. R. (2d) 338, 106 D.L.R. (3d) 81, [1980] 1 W.W.R. 323 (C.A.); *Oliver v. Ruge* (1990), 46 B.L.R. 50 (Ont. H.C.J.); *Brant Investments v. KeepRite* (1991), 3 O.R. (3d) 289, 80 D.L.R. (4th) 161 (C.A.).

⁷⁵ B. Welling *et al.*, *Canadian Corporate Law: Cases, Notes & Materials* (Toronto: Butterworths, 1996) 228.

⁷⁶ *BCBA*, *supra* note 56, s. 15(1), *OBCA*, *supra* note 72, s. 15.

⁷⁷ Welling *et al.*, *supra* note 75 at 32-36.

At issue here is the justifiability of an apparent bias in issuer bid regulation in favour of exiting shareholders. It is submitted that the bias is unjustifiable. If a bias is inherent in a permitted transaction, then that bias should favour remaining shareholders and others who have an interest in the long-term prospects of the corporation. With respect to the regulation governing issuer bids, regulators must turn their minds to the biases inherent in regulation and to the reasons why such biases exist. Only then can regulation be justified as a device for protecting those shareholders who stand to be disadvantaged by the particular securities transaction under consideration.

B. Controlling Shareholders versus Minority Shareholders

A further concern relating to the proposals in this paper may arise when one considers the structure of the shareholder base of public companies in Canada. Many Canadian public companies have a controlling shareholder which may or may not be an institutional holder. The controlling shareholder may be closely related to or be comprised of members of the issuer's management. The controlling shareholder may have access to inside information, which enables it to value the company's stock more accurately than minority shareholders. The controlling shareholder may use the Dutch auction issuer bid, as modified by the current proposal, to exploit its superior information regarding the value of the issuer to the detriment of minority shareholders.⁷⁸ Where institutional investors hold a large block of shares, those institutional investors may refuse to tender their block to the issuer in an attempt to bid up the offer price.

However, the very purpose of the issuer bid circular is to close the information gap, if it indeed exists, between the corporation and/or controlling shareholders on the one hand and minority shareholders on the other. If regulators are concerned that minority shareholders may be exploited because they lack information that controlling shareholders possess, then this is an issue that needs to be addressed in the regulation regarding the level of disclosure in issuer bid circulars. For instance, a requirement could be imposed on issuers to deliver to all shareholders any material information which was, prior to the commencement of the Dutch auction, provided to the controlling shareholder for any reason during the previous year and any information regarding the value of the relevant security during the previous 3 years. In addition, the definition of what information is considered to be "material" for the purposes of the issuer bid circular could be redrafted to ensure more detailed disclosure.

Each shareholder has varying levels of information about the particular security in which he or she trades. It is a regular occurrence for shareholders to trade on the basis of these differing levels of information. The issuer bid need not be treated any differently from trading on the secondary market. Admittedly, retail shareholders may not have access to in-house valuations completed by an institutional holder. However, they are able to rely on their broker's advice in dealing with their securities. In any

⁷⁸ Note that in some Dutch auctions, shareholders are entitled to participate in the bid by completing a proportionate tender. Further discussion of pro rata take-up rules will be found below.

case, if the concern is that controlling shareholders have information which other shareholders do not have access to, then such concern should be a sounding bell for heightened disclosure obligations. Moreover, the current rules regarding Dutch auctions, conventional issuer bids and securities regulation generally, need to be re-examined in order to take into account a Canadian shareholder base that contains large institutional investors and a preponderance of controlling shareholders.

A further issue relating to the current proposal arises if one considers that a controlling shareholder could increase its ownership in the corporation in one of two ways: it could launch a take-over bid for the corporation (an "insider bid") or encourage the corporation to complete a Dutch auction.⁷⁹ Under the current proposal, the cost of completing an issuer bid would almost certainly be less than the cost of completing a take-over bid. It would be useful to address this concern by requiring disclosure in the issuer bid circular as to whether or not the controlling shareholder plans to tender to the Dutch auction. If shareholders intending to sell shares into the bid knew in advance that the controlling shareholder was not going to tender (and thereby planned to increase its ownership position), they would likely tender at a higher price. Disclosure of a controlling shareholder's intentions would thus narrow the gap in cost between these two methods of increasing share ownership.

In any case, directors of the issuer still have a fiduciary obligation under corporate statutes to act in the best interests of the corporation.⁸⁰ As a result of this obligation, it may not be possible for a controlling shareholder simply to choose whether to increase its ownership by way of an insider bid or issuer bid. Directors of the issuer, who may include nominees of a controlling shareholder, would have to consider whether it would be in the best interests of the corporation to use corporate assets or incur debt to repurchase its shares. Thus, although a controlling shareholder could launch an insider bid at any time, its ability to influence the issuer to complete a Dutch auction is limited.

C. *Pro Rata Take-Up*

If the above argument is accepted and an issuer is permitted to repurchase its shares at their tendered prices, it follows that the issuer should also be exempted from the rule with respect to pro rata take-up. This rule stipulates that if more securities are tendered to the bid than the issuer desires to purchase, the issuer will purchase the securities on a pro rata basis.⁸¹ In other words, the issuer will not purchase 100 per cent

⁷⁹ The question arises as to whether take-over bids and issuer bids should be regulated identically. At first glance, there are reasons to support retaining a principle of equality of result in the take-over bid context. There is great potential for abuse if acquiring corporations in a take-over bid are permitted to purchase shares at varying prices. Controlling shareholders would likely be paid higher premiums than minority shareholders, making the latter vulnerable. Fall-out from this abuse could include investor reluctance to purchase shares in companies with controlling shareholders.

⁸⁰ *CBCA*, *supra* note 56, s. 122(1)(a).

⁸¹ See *e.g. OSA*, *supra* note 1, s. 95(7).

of the securities tendered by any one shareholder but rather, will purchase an equal percentage of securities from each shareholder who tenders to the offer. This rule is at odds with the current proposal. Proration may be necessary at the highest price at which an issuer purchases shares.⁸²

One of the rationales underlying proportionate take-up provisions is that it is necessary to treat shareholders equally; it would be unfair if the issuer indiscriminately purchased 100 per cent of the tendered securities from one shareholder but did not purchase 100 per cent from another shareholder. However, if the argument in this paper is accepted and shares could be repurchased at the various prices at which they were tendered, it would not make sense to require an issuer to repurchase shares on a pro rata basis. Obviously, the issuer would purchase shares beginning with those tendered at the lowest prices first. Proration continues to make sense at the highest price at which shares are repurchased. For example, if the highest price at which shares are repurchased is \$25 and more shares are tendered at \$25 than the issuer seeks to repurchase after having purchased all tendered shares below this price, then the issuer should be required to purchase shares on a pro rata basis from shareholders who tendered at \$25.

Conclusion

Securities regulatory authorities in Canada are committed to the concepts of equality and fairness. In some cases, this commitment has not entailed an assessment of whether the commitment is justified in a particular instance. The Dutch auction is one case in which equality of opportunity may be seen to be achieved through appropriate disclosure to shareholders. Once shareholders are made aware of all information provided to controlling shareholders, including the mechanics of the bid, through disclosure in an issuer bid circular, they can be considered to have been treated equally. In a Dutch auction, equal treatment should not be synonymous with identical treatment in terms of the consideration which is ultimately paid to tendering shareholders.⁸³

At the end of the day, the question must be asked: why do the interests of tendering shareholders take priority over those of remaining shareholders? It seems to be a perverse result that the interests of shareholders who decide to hold onto their investment in an issuer are, as a result of securities regulation, considered secondary to the

⁸² In its current regulation of Dutch auctions, the OSC has demonstrated some willingness to depart from the pro rata take-up rule (see *supra* note 54). In 1977, United Aircraft offered to buy-back shares at prices specified by shareholders up to a maximum price stated in the offer. Shares were to be accepted in ascending order of prices specified until the aggregate number to be purchased were assembled. The SEC approved the proposals and issued a no-action letter in response (see Lederman & Vlahakis, *supra* note 9 at 814).

⁸³ Admittedly, one of the appealing aspects of the Dutch auction as it currently operates is that shareholders who tender at a lower price may receive a higher price for their shares. In fact, it is possible that these shareholders would not have tendered at all had there been no clearing price rule.

interests of shareholders who elect to divest themselves of such investment. This result is a far cry from the rule in *Trevor v. Whitworth* which prohibited a corporation from repurchasing its own shares out of concern for creditors.

When devising regulation, securities regulators should consider the interests of all parties affected by a transaction and the biases which are inherent in such regulation . In the case of the Dutch auction, it would be more fair to allow issuers to pay prices chosen by tendering shareholders within the range established by the issuer. In this way, the ultimate cost of the bid would be lower, tendering shareholders would be treated fairly, and remaining shareholders, creditors, employees and management would be better off.
