TAB "15"

Only the Westlaw citation is currently available.

UNPUBLISHED OPINION. CHECK COURT RULES BEFORE CITING.

Court of Chancery of Delaware.
PHELPS DODGE CORPORATION, et al., Plaintiffs,
v.
CYPRUS AMAX MINERALS COMPANY, a Delaware corporation, et al., Defendants.
IN RE CYPRUS AMAX MINERALS COMPANY SHAREHOLDERS LITIGATION.
Maurice A. STERNS, et al., Plaintiffs,
v.
Francis R. McALLISTER, et al., Defendants.
Nos. CIV.A. 17398, CIV.A. 17383, CIV.A. 17427.

Sept. 27, 1999.

GREGORY P. WILLIAMS, ESQ. Richards, Layton & Finger and STUART J. BASKIN, ESQ. ALAN S. GOUDISS, ESQ., Of the New York Bar Shearman & Sterling for Plaintiffs in Civil Action No. 17398.

PAMELA S. TIKELLIS, ESQ. Chimicles, Jacobsen & Tikellis and MARC A. TOPAZ, ESQ., Of the New York Bar Schiffrin & Barroway and JOSHUA N. RUBIN, ESQ., Of the New York Bar Abbey, Gardy & Squitieri for Plaintiffs in Civil Action No. 17383.

CRAIG B. SMITH, ESQ. Smith, Katzenstein & Furlow and ROBERT C. FINKEL, ESQ., Of the New York BarWolf Popper for Plaintiffs in Civil Action No. 17427.

KENNETH J. NACHBAR, ESQ. Morris, Nichols, Arsht & Tunnell and PAUL K. ROWE, ESQ., Of the New York Bar Wachtell, Lipton, Rosen & Katz for Cyprus Amax Defendants.

STEVEN J. ROTHSCHILD, ESQ. Skadden, Arps, Slate, Meagher & Flom and ROBERT E. ZIMET, ESQ., Of the New York Bar Skadden, Arps, Slate, Meagher & Flom for Asarco Defendants.

CHANDLER

AFTERNOON SESSION

(Reconvened at 2:56 p.m.)

*1 THE COURT: First, counsel, I want you to know that I appreciate the time that you gave me to think about my decision. I also want you to know that I appreciate the tremendous effort that you have displayed not only in the briefing and discovery stages but in the oral arguments today, which were truly exemplary, eloquent and moving arguments, and quite enjoyable from the Court's perspective. I don't know how enjoyable they are from counsel's perspective, but from my end of it, they were wonderful to watch and listen to.

In the time that I have had since the arguments, I have thought carefully about the positions of each of the parties, and based on the briefs and the arguments, I think I am in a position to give you my provisional determination.

Of course, the application before the Court is an application for preliminary injunctive relief, and the standards for preliminary injunctions are well known. They are, first, that the moving party demonstrate a reasonable likelihood of success on the merits. In addition, the moving party must demonstrate that there is a reasonable threat of irreparable injury should the injunction not be issued. And finally, the moving party must demonstrate to the Court's satisfaction that the threat of injury from not issuing the injunction is greater than the threat of injury that would result from issuing the injunction, the so-called balancing of the equities part of

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the test.

Now, based on the limited record in front of the Court, it is my judgment that the plaintiffs have demonstrated a reasonable probability of success on the merits of this litigation with respect to one part at least. I must admit that the defendants' no-talk and termination fee provisions are troubling to the Court. And this decision, however, is a provisional decision based on a limited record, as are all preliminary injunction matters based on limited records. But I want to turn first to the area that concerns the Court the most.

Under our law, a board of directors must be informed of all material information reasonably available. The defendants properly argue that Cyprus Amax and Asarco are under no duty to negotiate, under the teachings of Time Warner and other cases in the Delaware Court of Chancery and Supreme Court. And in a transaction not involving a change of control or sale of the company, that is undoubtedly the case. Nevertheless, even the decision not to negotiate, in my opinion, must be an informed one. A target can refuse to negotiate under Time Warner, but it should be informed when making such refusal.

The board of Time, for example, may have refused in the exercise of its business judgment to negotiate with Paramount, but its refusal was not claimed to be an uninformed one. That is, Time's board had not ex ante bargained away its right to even become informed about whether or not to negotiate.

No-talk provisions, thus, in my view, are troubling precisely because they prevent a board from meeting its duty to make an informed judgment with respect to even considering whether to negotiate with a third party.

*2 Now, here, despite the presence of publicly exchanged information, the no-talk provision has apparently prevented either Cyprus or Asarco from engaging in nonpublic dialogue with Phelps. Now, this should not be understood to suggest that Cyprus or Asarco were legally required to or even should have negotiated, privately or otherwise, with Phelps Dodge. It is to say, rather, that they simply should not have completely foreclosed the opportunity to do so, as this is the legal equivalent of willful blindness, a blindness that may constitute a breach of a board's duty of care; that is, the duty to take care to be informed of all material information reasonably available.

Now, given my ruling of reasonable success on the merits with respect to the plaintiffs' duty of care claim, I don't think it is necessary or required that I reach their Unocal claim. Consequencely, I do not take up plaintiffs' challenge to the termination fee as being unduly coercive, although I think 6.3 percent certainly seems to stretch the definition of range of reasonableness and probably stretches the definition beyond its breaking point. But I need not reach this issue because, despite plaintiffs' showing of a reasonable probability of success on the merits, I remain unconvinced that irreparable injury will result if this injunction is not granted.

Phelps' contention that it will walk away after a merger is consummated between Cyprus and Asarco is a self-inflicted harm. This Court cannot and, in my judgment, should not save one from oneself.

I also need not rescue the shareholders from losing out on a premium bid, as they can simply vote down the Cyprus/Asarco transaction which is scheduled to be voted on this Thursday. When such self-help measures are clearly available and when the arsenals of all parties have been unleashed so as to fully and completely educate the shareholders of their choices, it is not for this Court to ride to their rescue.

And even if the Court were to invalidate the challenged provisions, it is not clear that such relief will benefit the shareholders voting on Thursday. Plenty of information, from all that I can tell, is already available in the marketplace.

More importantly, an injunction would likely force

the boards of Cyprus Amax and Asarco to delay their respective shareholders meetings in order to gather more information, and that delay in itself poses a clear and present risk to the potential Cyprus/Asarco transaction which the shareholders may be in favor of. The risk to the transaction already on the table, in other words, outweighs the de minimus harm that Phelps Dodge and the shareholder plaintiffs have asserted credibly here today.

And so for these reasons I deny the application for injunctive relief. And to the extent that an order is necessary to implement this determination, it is so ordered.

Del.Ch.,1999.
Phelps Dodge Corp. v. Cyprus Amax Minerals Co.
Not Reported in A.2d, 1999 WL 1054255 (Del.Ch.)

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TAB "16"

Ventas, Inc. et al. v. Sunrise Senior Living Real Estate Investment Trust et al.

[Indexed as: Ventas, Inc. v. Sunrise Senior Living Real Estate Investment Trust]

Court of Appeal for Ontario, Blair, MacFarland and LaForme JJ.A.
March 23, 2007

Contracts — Interpretation and construction — Vendor's board of trustees offering to sell its assets through auction process and entering into Confidentiality Agreements with interested bidders which contained Standstill Agreements preventing each prospective acquiring party from attempting hostile unsolicited takeover bid — Vendor signing purchase agreement with one bidder subject to unitholder approval — Second bidder then submitting superior bid — Application judge not erring in interpreting purchase agreement as imposing obligation on vendor to enforce its Standstill Agreement with second bidder and as precluding it from considering acquisition proposal submitted by that bidder.

Sunrise was a Canadian public real estate investment fund which owned and invested in senior living communities. It undertook a strategic sale process of its assets. Both HCPI and Ventas were interested in bidding, and each was required to enter into a Confidentiality Agreement with Sunrise in order to prevent non-public information exchanged by the parties from being publicly disclosed. The Confidentiality Agreements contained restrictions preventing each prospective acquiring party from attempting a hostile (unsolicited) takeover bid (the "Standstill Agreements"). Ventas submitted a successful bid to acquire all of the assets for a price of $15 per unit, subject to shareholder approval. HCPI withdrew from the auction process and did not bid at that time. Instead, it put forward a post-auction bid, after it knew what Ventas had offered, of $18 per unit. Ventas brought an application for a declaration that Sunrise was required to enforce the Standstill Agreement it had entered into with HCPI, thereby preventing it from considering the HCPI Proposal. The application was granted. Sunrise and HCPI appealed.

Held, the appeal should be dismissed.

The application judge was correct in interpreting s. 4.4 of the Purchase Agreement as imposing an obligation on Sunrise to enforce the Standstill Agreement between it and HCPI, thus precluding it from considering the acquisition proposal submitted by HCPI following the close of the auction and after the Ventas bid had been accepted. She found this to be objectively reasonable and a form of protection afforded to Ventas as part of the package negotiated between it and Sunrise. The application judge did not fail to consider the factual matrix underlying the negotiation of the Purchase Agreement and did not fail to give effect to the "commercial sense" component of contract interpretation. The application judge was sensitive to the fiduciary out provisions of the Agreement that permitted other *bona fide* written unsolicited Acquisition Proposals. In her view, this was balanced, objectively and reasonably, by the requirement that Sunrise ensure enforcement of Standstill Agreements that had been signed as part of the auction process in order to protect the successful bidder. This interpretation made commercial sense. It was unnecessary to adopt the principle gleaned from some American authorities that the target vendor can place no limits on the directors' right to consider superior offers and that any provision to the contrary is invalid and unenforceable. That was not what happened in this case. The trustees did not contract away their fiduciary obligations. Rather, they complied with

them by setting up an auction process that was designed to maximize the unit price obtained for Sunrise's assets, in a fashion resembling a "shotgun" clause, by requiring bidders to come up with their best price in the second round, subject to a fiduciary out clause that allowed them to consider superior offers from anyone save only those who had bound themselves by a Standstill Agreement in the auction process not to make such a bid. The application judge viewed "*bona fide*" as meaning acting "in good faith; sincere; genuine", and found that the HCPI Acquisition Proposal was not *bona fide* because it was made in breach of the HCPI Standstill Agreement. The application judge did not err in her assessment and use of the term "*bona fide*".

Cases referred to

ACE Ltd. v. Capital Re Corp., 747 A. 2d. 95 (Del. Ch. 1999); *BG Checo International Ltd. v. British Columbia Hydro & Power Authority*, [1993] 1 S.C.R. 12, [1993] S.C.J. No. 1, 7 B.C.L.R. (2d) 145, 99 D.L.R. (4th) 577, 147 N.R. 81, [1993] 2 W.W.R. 321, 14 C.C.L.T. (2d) 233; *Consolidated Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co.*, [1980] 1 S.C.R. 888, [1979] S.C.J. No. 133, 112 D.L.R. (3d) 49, 32 N.R. 488, [1980] I.L.R. ¶1-1176; *CW Shareholdings Inc. v. WIC Western International Communications Ltd.* (1998), 39 O.R. (3d) 755, [1998] O.J. No. 1886, 160 D.L.R. (4th) 131, 38 B.L.R. (2d) 196 (Gen. Div.); *Eli Lilly and Co. v. Novopharm Ltd.*, [1998] 2 S.C.R. 129, [1998] S.C.J. No. 59, 161 D.L.R. (4th) 1, 227 N.R. 201, 80 C.P.R. (3d) 321; *Kentucky Fried Chicken Canada, a Division of Pepsi-Cola Canada Ltd. v. Scott's Food Services Inc.*, [1998] O.J. No. 4368, 114 O.A.C. 357 (C.A.); *Maple Leaf Foods Inc. v. Schneider Corp.* (1998), 42 O.R. (3d) 177, [1998] O.J. No. 4142, 44 B.L.R. (2d) 115 (C.A.); *Paramount Communications, Inc. v. QVC Network Inc.*, 637 A. 2d 34 (Del. 1994); *Scanlon v. Castlepoint Development Corp.* (1992), 11 O.R. (3d) 744, [1992] O.J. No. 2692, 9 D.L.R. (4th) 153, 29 R.P.R. (2d) 60 (C.A.); *Toronto (City) v. W.H. Hotel Ltd.*, [1966] S.C.R. 434, [1966] S.C.J. No. 23, 56 D.L.R. (2d) 539; *Toronto-Dominion Bank v. Leigh Instruments Ltd. (Trustee of)* (1999), 45 O.R. (3d) 417, [1999] O.J. No. 3290, 178 D.L.R. (4th) 634, 50 B.L.R. (2d) 64 (C.A.), affg [1998] O.J. No. 2637, 40 B.L.R. (2d) 1 (Gen. Div.); *Venture Capital USA Inc. v. Yorkton Securities Inc.* (2005), 75 O.R. (3d) 325, [2005] O.J. No. 1885, 197 O.A.C. 264, 4 B.L.R. (4th) 324 (C.A.)

Authorities referred to

McCamus, J.D., *The Law of Contracts* (Toronto: Irwin Law, 2005)

APPEAL from the order of Pepall J., [2007] O.J. No. 908, 156 A.C.W.S. (3d) 343 (S.C.J.), allowing an application for a declaration that the vendor was prevented by its agreement with the applicant from considering a bid submitted by the respondent.

Peter F.C. Howard and *Eliot Kolers*, for appellants Sunrise Senior Living Real Estate Investment Trust, Sunrise REIT Trust, and Sunrise REIT GP Inc.

Jeffrey S. Leon and *Derek J. Bell*, for appellants Health Care Property Investors, Inc.

Mark A. Gelowitz and *Laura K. Fric*, for respondents Ventas, Inc. and numbered companies.

Luis G. Sarabia and *Cynthia Spry*, for respondent Sunrise Senior Living Inc.

The judgment of the court was delivered by

BLAIR J.A.: —

Overview

[1] Sunrise REIT is a Canadian public real estate investment trust whose units are traded on the Toronto Stock Exchange. It owns and invests in senior living communities in Canada and the United States. In September 2006, Sunrise's board of trustees determined that a strategic sale process of its assets would be beneficial to its unitholders, thus effectively putting Sunrise "in play" on the public markets.

[2] To carry out this plan, the Trustees developed a two-stage auction process with a view to maximizing the value of Sunrise's units. Ventas, Inc. ("Ventas") and Health Care Property Investors, Inc. ("HCPI") were two of seven initially interested prospective purchasers in the auction process. They emerged from the preliminary round as the only two potential bidders asked to participate in the final round.

[3] Ventas submitted a successful bid to acquire all of Sunrise's assets for a total purchase price of $1,137,712,410 (representing a price of $15 per unit), subject to unitholder approval. HCPI withdrew from the auction process and did not bid at that time. Instead, it put forward a post-auction bid — after it knew what Ventas had offered — "topping up" the Ventas offer by 20 per cent to $18 per unit. This increased offer represents an additional $227.5 million for the unitholders, who are to meet on March 30, 2007, to consider the Ventas proposal.

[4] Hence the urgency of this appeal.

[5] The appeal turns on the interpretation of the terms of the purchase agreement executed by Sunrise and Ventas following acceptance of the Ventas bid. The issue is whether Sunrise is obliged to enforce the terms of a prior standstill agreement entered into between it and HCPI in the course of the auction process and which prohibits HCPI from making an offer for the Sunrise assets without Sunrise's consent. If the answer to that question is "Yes", Sunrise will be precluded from considering or accepting the richer HCPI offer pending the unitholders' meeting.

[6] Following an urgent application, determined on March 6, 2007, Justice Pepall answered the foregoing question in the affirmative. Sunrise and HCPI appeal from that decision. Ventas supports it.

[7] For the reasons that follow, I would dismiss the appeal and uphold the decision of the application judge.

Facts

[8] As mentioned above, Sunrise owns and invests in senior living communities in Canada and the United States. The properties are managed by Sunrise Senior Living, Inc. ("SSL"), a U.S. public company whose shares are traded on the New York Stock Exchange.

[9] HCPI is a self-administered real estate investment trust that also invests in healthcare facilities. Ventas is a U.S.-based health care real estate investment trust whose shares are listed on the New York Stock Exchange.

[10] In September 2006, after Sunrise's board of trustees determined that a strategic sale process of the Trust's assets would be beneficial to its unitholders, it began an auction process with a view to maximizing unitholder value.

[11] Parties who were interested in acquiring Sunrise (including HCPI and Ventas) were required to enter into a confidentiality agreement with it in order to prevent non-public information exchanged by the parties from being publicly disclosed (the "Confidentiality Agreements"). The Confidentiality Agreements contained restrictions preventing each prospective acquiring party from attempting a hostile (unsolicited) takeover bid (the "Standstill Agreements").

[12] Although the parties' Confidentiality Agreements were largely similar, Ventas's Standstill Agreement was worded differently from HCPI's in that the Ventas standstill ceased to apply if, among other things, Sunrise entered into an agreement to sell more than 20 per cent of its assets to a third party. Notably, HCPI's Standstill Agreement did not contain a similar termination clause.

[13] On November 21, 2006, Sunrise invited potential bidders to submit bids in the non-binding preliminary round of an auction. After the first round of bids, Sunrise invited HCPI and Ventas to engage in further negotiations and on December 29, 2006, it invited them to submit final binding bids in the second round of the auction by January 8, 2007. Sunrise waived the Standstill Agreements with those bidders for that purpose, and HCPI and Ventas were expressly told not to assume that the "winning" bid was assured of actually acquiring Sunrise at the price agreed upon or that they would be given an opportunity to rebid, renegotiate, or improve the terms of their proposal.

[14] Ventas submitted a second bid on January 8, but HCPI withdrew from the auction and did not.

[15] On January 14, 2007, Ventas and Sunrise signed an agreement contemplating the purchase by Ventas of all of Sunrise's assets for a total purchase price of $1,137,712,410 (representing a price of $15 per Unit), subject to Unitholder approval (the

"Purchase Agreement"). This price represented a 35.8 per cent premium over the closing price of the units on January 12, 2007. The Purchase Agreement contemplated subsequent third-party unsolicited bids and allowed Sunrise to accept such a bid if it was financially superior to Ventas's bid.

[16] On January 17, 2007, Sunrise notified HCPI of the agreement with Ventas and asked for the return of Sunrise's confidential materials. In the letter, Sunrise's solicitor reminded HCPI of the terms of the Confidentiality Agreement it signed in November 2006.

[17] On February 14, 2007, HCPI submitted a proposal to acquire all of Sunrise's assets for $18 per unit (the "HCPI Proposal"), conditional on HCPI's ability to reach a management agreement with SSL. Sunrise treated the HCPI Proposal as an unsolicited third-party bid, but it concluded that it was not in a position to determine whether the bid was a superior bid because of the SSL condition.

[18] The Confidentiality Agreements entered into in the course of the auction process contained a provision prohibiting prospective purchasers from communicating with SSL. This was because SSL was viewed as a possible bidder. Following the preliminary round of the auction, in late November 2006, and after realizing that SSL was not an interested purchaser, Sunrise had authorized its financial advisors to arrange to allow HCPI and Ventas to contact SSL for purposes of the second round of bidding. On February 15, 2007, however — after learning of the HCPI Proposal — Ventas advised Sunrise that, if it permitted communications between SSL and HCPI, Sunrise would be in breach of the Purchase Agreement. It did not assert that HCPI would be in breach of its Standstill Agreement because it apparently assumed that HCPI's Standstill Agreement was worded similarly to the Ventas Standstill Agreement, which meant that the restraint on an unsolicited bid was no longer enforceable since Sunrise had entered into an agreement with a third party.

[19] On February 18, 2007, Sunrise served application materials upon Ventas, HCPI and SSL indicating its intention to seek the court's interpretation of the Purchase Agreement, specifically on the issue of communications between HCPI and SSL. It is at this point that Ventas learned of the specific terms of HCPI's Confidentiality Agreement and realized that HCPI's Standstill Agreement did not contain the same termination clause as Ventas's Standstill Agreement. On February 21, 2007, Ventas brought the within application seeking a declaration that Sunrise was required to enforce its Standstill Agreement with HCPI, thereby preventing it from considering the HCPI Proposal.

[20] The application judge found that Sunrise had agreed with Ventas that it would enforce existing Standstill Agreements and that any bid made in breach of an existing Standstill Agreement would not be *bona fide*. She then concluded that Sunrise was required to enforce the Standstill Agreement with HCPI and that HCPI did not have prior written consent to submit its bid. She dismissed Sunrise's application on the grounds that the issue was moot in light of her earlier conclusion.

The Provisions of the Agreement

[21] Section 4 of the Purchase Agreement deals generally with the covenants of the parties. Section 4.4 deals with Sunrise's "Covenants Regarding Non-Solicitation". Because of their importance, I reproduce the provisions of s. 4.4 in their entirety (the underlining is mine):

> 4.4(1) Following the date hereof, Sunrise REIT shall not, directly or indirectly, through any trustee, officer, director, agent or Representative of Sunrise REIT or any of its Subsidiaries, and shall not permit any such Person to,
>
> (i) solicit, initiate, encourage or otherwise facilitate (including by way of furnishing information or entering into any form of agreement, arrangement or understanding or providing any other form of assistance) the initiation of any inquiries or proposals regarding, or other action that constitutes, or may reasonably be expected to lead to, an actual or potential Acquisition Proposal,
>
> (ii) participate in any discussions or negotiations in furtherance of such inquiries or proposals or regarding an actual or potential Acquisition Proposal or release any Person from, or fail to enforce, any confidentiality or standstill agreement or similar obligations to Sunrise REIT or any of its Subsidiaries,
>
> (iii) approve, recommend or remain neutral with respect to, or propose publicly to approve, recommend or remain neutral with respect to, any Acquisition Proposal,
>
> (iv) accept or enter into any agreement, arrangement or understanding, related to any Acquisition Proposal (other than a confidentiality agreement contemplated in Section 4.4(2)), or
>
> (v) withdraw, modify or qualify, or publicly propose to withdraw, modify or qualify, in any manner adverse to the Purchasers, the approval or recommendation of the Board (including any committee thereof) of this Agreement or the transactions contemplated hereby.
>
> (2) Notwithstanding anything contained in Section 4.4(1), until the Unitholder Approval, nothing shall prevent the Board from complying with Sunrise REIT's disclosure obligations under applicable Laws with regard to a *bona fide* written, unsolicited Acquisition Proposal or, following the receipt of any such Acquisition Proposal from a third party (that did not result from a breach of this Section 4.4), from furnishing or disclosing non-public information to such Person if and only to the extent that:

(i) the Board believes in good faith (after consultation with its financial advisor and legal counsel) that such Acquisition Proposal if consummated could reasonably be expected to result in a Superior Proposal; and

(ii) such third party has entered into a confidentiality agreement containing terms in the aggregate no more favourable to such third party than those in the Confidentiality Agreement as are then in effect in accordance with its terms.

(3) Notwithstanding anything, contained in Section 4.4(1), until the Unitholder Approval, nothing shall prevent the Board from withdrawing or modifying, or proposing publicly to withdraw or modify its approval and recommendation of the transactions contemplated by this Agreement, or accepting, approving or recommending or entering into any agreement, understanding or arrangement providing for a *bona fide* written, unsolicited Acquisition Proposal (that did not result from a breach of this Section 4.4) ("Proposed Agreement") if and only to the extent that:

(i) it has provided the Purchasers with a copy of all of the documents relating to the Acquisition Proposal,

(ii) the Board, believes in good faith (after consultation with its financial advisor and legal counsel) that such Acquisition Proposal constitutes a Superior Proposal and has promptly notified the Purchasers of such determination,

(iii) a period of at least five Business Days (the "Matching Period") has elapsed following the later of (x) the date the Purchasers received written notice advising the Purchasers that the Board has resolved, subject to compliance with this Section 4.4(3), to withdraw, modify its approval and recommendation of the transactions contemplated by this Agreement or accept, approve or recommend or enter into a Proposed Agreement in respect of such Superior Proposal and (y) the date the Purchasers received a copy of the documentation related to such Superior Proposal pursuant to Section 4.4(3)(i),

(iv) if the Purchasers have proposed to amend the transactions contemplated under this Agreement in accordance with Section 4.4(6), the Board has again made the determination in Section 4.4(3)(ii) taking into account such proposed amendments, and

(v) if Sunrise REIT proposes to enter into a Proposed Agreement (other than a confidentiality agreement referred to in Section 4.4(2)) after complying with this Section 4.4(3), Sunrise REIT shall have complied with Section 5.2 and 5.3. For the purposes of this Section 4.4(3) the preparation and delivery of a directors' circular pursuant to Section 99 of the *Securities Act* relating to an Acquisition Proposal shall be deemed to be a qualification, withdrawal or modification, of the Board's recommendation of the transactions contemplated hereby unless the Board expressly, and without qualification, reaffirms its recommendation of the transactions contemplated hereby in such disclosure.

(4) If the expiry of the Matching Period referred to in Section 4.4(3)(iii) falls on a date which is less than five Business Days prior to the Unitholder Meeting,

Sunrise REIT shall, at the request of the Purchasers, adjourn the Unitholder Meeting to a date that is not more than 10 Business Days following such expiry date.

(5) Sunrise REIT acknowledges and agrees that each successive amendment to any Acquisition Proposal shall constitute a new Acquisition Proposal for purposes of section 4.4.

(6) During the Matching Period, the Purchasers shall have the right, but not the obligation, to propose to amend the terms of this Agreement. The Trustees will review any proposal by the Purchasers to amend the terms of this Agreement in good faith in order to determine (after consultation with their financial advisor and legal counsel) whether the transactions contemplated by this Agreement, taking into account the Purchasers' proposed amendments would, if consummated in accordance with its terms, result in the Superior Proposal ceasing to be a Superior Proposal. If the Trustees so determine, Sunrise REIT will enter into an amending agreement with the Purchasers reflecting such proposed amendment.

(7) Sunrise REIT shall, as promptly as practicable, notify the Purchasers of any relevant details relating to any Acquisition Proposal, or inquiry that could reasonably be expected to lead to any Acquisition Proposal, or any amendments to any Acquisition Proposal (including the identity of the parties and all material terms thereof), or any request for non-public information relating to Sunrise REIT or any of its Subsidiaries in connection with an Acquisition Proposal or inquiry that could reasonably be expected to lead to any Acquisition Proposal, or for access to the properties, books or records of Sunrise REIT or any of its Subsidiaries by any Person that informs Sunrise REIT or such Subsidiary that it is considering making, or has made, an Acquisition Proposal, or inquiry that could reasonably be expected to lead to any Acquisition Proposal, in each case which any of Sunrise REIT, any of its Subsidiaries or any officer, trustee, director, employee or Representative may receive after the date hereof relating to an Acquisition Proposal. Sunrise REIT shall promptly and fully keep the Purchasers informed of the status on a current basis, including any change to any of the terms, of any such Acquisition Proposal.

(8) Sunrise REIT shall

(i) ensure that its officers and Trustees and its Subsidiaries and their respective officers and directors and any Representatives retained by it or its Subsidiaries in connection herewith are aware of the provisions of this Section 4.4, and Sunrise REIT shall be responsible for any breach of this Section 4.4 by its [*sic*] and its Subsidiaries' officers, directors, trustees or representatives;

(ii) immediately cease and cause to be terminated any existing activities, discussions or negotiations with any parties conducted heretofore with respect to any Acquisition Proposal;

(iii) require all Persons other than the Purchasers who have been furnished with confidential information regarding Sunrise REIT or its Subsidiaries in connection with the solicitation of or discussion regarding any Acquisition Proposal within 12 months prior to the date hereof promptly to return or destroy such information, in accordance with and subject to the terms of the confidentiality agreement entered into with such Persons;

(iv) terminate access for all Persons (other than the Purchasers and its Representatives) of the electronic dataroom accessible through Merrill Datasite's website; and

(v) not amend, modify, waive or fail to enforce any of the standstill terms or other conditions included in any of the confidentiality agreements between Sunrise REIT and any third parties.

[22] The Purchase Agreement defines "Acquisition Proposal" and "Superior Proposal" as follows:

"Acquisition Proposal" means any proposal or offer made by any Person other than the Purchasers (or any affiliate of the Purchasers or any Person acting jointly and/or in concert with the Purchasers or any affiliate of the Purchasers) with respect to the acquisition, directly or indirectly, of assets, securities or ownership interests of or in Sunrise REIT or any of its Subsidiaries representing 20% or more of the consolidated assets of Sunrise REIT and its Subsidiaries taken as a whole, in a single transaction or a series of transactions, or, of equity interests representing a 20% or greater economic interest in Sunrise REIT or such Subsidiaries taken as a whole, in a single transaction or a series of transactions pursuant to any merger, amalgamation, tender offer, share exchange, business combination, liquidation, dissolution, recapitalization, take-over or non-exempt issuer bid, amendment to the Declaration of Trust, redemption of units, extraordinary distribution, sale, lease, exchange, mortgage, pledge, transfer, purchase, or issuance as consideration or similar transaction or series of transactions involving Sunrise REIT or any of such Subsidiaries or any other transaction the consummation of which would reasonably expected to impede, interfere with, prevent or materially delay the transactions contemplated hereby.

"Superior Proposal" means any unsolicited *bona fide* written Acquisition Proposal made by a third party that in the good faith determination of the Trustees, after consultation with its financial advisors and with outside counsel:

(a) is reasonably capable of being completed without undue delay having regard to financial, legal, regulatory and other matters;

(b) in respect of which adequate arrangements have been made to ensure that the required funds will be available to effect payment in full of the consideration; and

(c) would, if consummated in accordance with its terms, result in a transaction more favourable to Unitholders from a financial point of view (including financing terms, any termination fee or expenses reimbursement payable under this Agreement, any conditions to the consummation thereof) than the transactions contemplated by this Agreement; provided, however, that for purposes of this definition the references in the definition of Acquisition Proposal to "20%" shall be deemed to be references to "100%".

Analysis

[23] The central issue on this appeal, as it was before the application judge, is whether the provisions of s. 4.4 of the Purchase Agreement impose an obligation on Sunrise to enforce the Standstill

Agreement between it and HCPI, thus precluding it from considering the Acquisition Proposal submitted by HCPI following the close of the auction and after the Ventas bid had been accepted. In my view, they do.

[24] Counsel accept that the application judge correctly outlined the principles of contractual interpretation applicable in the circumstances of this case. I agree. Broadly stated — without reproducing in full the relevant passages from her reasons (paras. 29-34) in full — she held that a commercial contract is to be interpreted,

(a) as a whole, in a manner that gives meaning to all of its terms and avoids an interpretation that would render one or more of its terms ineffective;[1]

(b) by determining the intention of the parties in accordance with the language they have used in the written document and based upon the "cardinal presumption" that they have intended what they have said;[2]

(c) with regard to objective evidence of the factual matrix underlying the negotiation of the contract, but without reference to the subjective intention of the parties;[3] and (to the extent there is any ambiguity in the contract),

(d) in a fashion that accords with sound commercial principles and good business sense, and that avoid a commercial absurdity.[4]

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1 *BG Checo International Ltd. v. British Columbia Hydro and Power Authority*, [1993] 1 S.C.R. 12, [1993] S.C.J. No. 1, at pp. 23-24 S.C.R.; *Scanlon v. Castlepoint Development Corp.* (1992), 11 O.R. (3d) 744, [1992] O.J. No. 2692 (C.A.), at p. 770 O.R.

2 *Toronto-Dominion Bank v. Leigh Instruments Ltd. (Trustee of)*, [1998] O.J. No. 2637, 40 B.L.R. (2d) 1 (Gen. Div.), at para. 403, affd (1999), 45 O.R. (3d) 417, [1999] O.J. No. 3290 (C.A.); *Venture Capital USA Inc. v. Yorkton Securities Inc.* (2005), 75 O.R. (3d) 325, [2005] O.J. No. 1885 (C.A.), at para. 26; *Eli Lilly & Co. v. Novopharm Ltd.*, [1998] 2 S.C.R. 129, [1998] S.C.J. No. 59, at pp. 166-68 S.C.R. ("*Eli Lilly*").

3 *Eli Lilly, ibid.* at p. 166 S.C.R.; *Kentucky Fried Chicken Canada, a Division of Pepsi-Cola Canada Ltd. v. Scott's Food Services Inc.*, [1998] O.J. No. 4368, 114 O.A.C. 357 (C.A.), at paras. 25-27 ("*Kentucky Fried Chicken*").

4 *Consolidated Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co.*, [1980] 1 S.C.R. 888, [1979] S.C.J. No. 133, at p. 901 S.C.R.; *Kentucky Fried Chicken, ibid.*

[25] The appellants assert, however, that the application judge misapplied the principles of contractual interpretation that she had properly enunciated. They say she did so essentially,

(a) by misapprehending the interplay between ss. 4.4(1), 4.4(2), 4.4(3) and 4.4(8)(v) of the Purchase Agreement and, in particular by failing to appreciate, and to reconcile, the differences between the wording of ss. 4.4(1) and 4.4(8), and more generally,

(b) by failing to understand the "architecture" of s. 4.4 of the Purchase Agreement and to consider it against the background of the factual matrix in which the Agreement was negotiated.

[26] I do not agree.

The application judge's reasoning

[27] The thrust of the application judge's reasoning in this regard is found at paras. 35, 36, 38 and 39 of her reasons:

> Sunrise REIT expressly and unambiguously agreed that it would not amend, modify, waive or fail to enforce any of the standstill terms or other conditions included in any of the confidentiality agreements between Sunrise REIT and any third parties. The standstill enforcement obligations are found in sections 4.4(1) and 4.4(8) of the Purchase Agreement.
>
> Sections 4.4(2) and 4.4(3) address Sunrise REIT's obligations with regard to "a *bona fide* written, unsolicited Acquisition Proposal (that did not result from a breach of this section 4.4)." Sections 4.4(2) and 4.4(3) are prefaced with the words "notwithstanding anything contained in section 4.4(1)." Sections 4.4(2) and (3) do not say "notwithstanding anything contained in section 4.4(1) or 4.4(8)." If it had been the parties' contractual intention to exempt the circumstances described in sections 4.4(2) and (3) from the operation of section 4.4(8), they could have so provided but they did not. Similarly, unlike sections 4.7 and 4.8 which commence with the words "notwithstanding any other term of the Agreement", sections 4.4(2) and 4.4(3) do not use this language.
>
> . . . . .
>
> It seems to me that the clear scheme of this Purchase Agreement was [to] ensure enforcement of standstill agreements that had been signed as part of the auction process. This strikes me as being objectively reasonable and was a form of protection afforded to the purchaser, Ventas. This was part of the package negotiated between it and Sunrise REIT.
>
> Such an interpretation derives from the words used by the parties to the Purchase Agreement and gives effect to the parties' intention. It is also consistent with the context of the transaction including the auction process which was the genesis of the Purchase Agreement. The Purchase Agreement does not preclude *bona fide* written unsolicited Acquisition Proposals nor does it preclude such a proposal from a party whose standstill agreement

> operated to permit such a proposal. It simply precludes a proposal from anyone who is in breach of its standstill agreement. While creative, I view Sunrise REIT's and HCP's interpretation arguments to be strained. They disregard the parties' intention and the true meaning of the subject sections and the Purchase Agreement as a whole.

(Footnote omitted)

The scheme and interpretation of section 4.4

[28] I agree with the application judge that an important purpose of this part of the Purchase Agreement is to ensure the enforcement of standstill agreements entered into by previous players in the auction process. The negotiating context demonstrates that Ventas has been skilful in protecting its own position with respect to competition and standstills — unlike the HCPI Standstill, the Ventas/Sunrise Standstill Agreement expired at the conclusion of the auction — and it is objectively reasonable, given this background, that it would seek protection against competition from those who were unsuccessful in the auction, particularly its [principal] competitor.

[29] From Sunrise's perspective, the safety valve lies in the unitholders' meeting. If the unitholders believe that there is a more favourable offer available — one worth the risk of rejecting the Ventas proposal — they may well vote to reject the Ventas proposal at their meeting on March 30.

[30] The language used by the parties in the Purchase Agreement supports this interpretation.

[31] Viewed contextually, ss. 4.4(1), 4.4(2), 4.4(3) and 4.4(8) form part of a section of the Purchase Agreement that deals with the general covenant of Sunrise not to shop for other offers pending unitholder consideration of the Ventas bid. Viewed in light of the factual matrix in which the Agreement was negotiated, the provisions provide deal protection for Ventas, as the successful bidder in the auction, subject to Sunrise REIT's fiduciary out obligations.

[32] As I read s. 4.4 of the Agreement, it has four major components. First, it contains the overriding obligation of Sunrise not to solicit other bids, buttressed by the commitment of Sunrise to enforce existing standstill agreements that may be in place with bidders who have already engaged in the auction process (s. 4.4(1)). Secondly, it contains the "fiduciary out" protection for the Sunrise Trustees (and unitholders), permitting the Trustees to consider *bona fide* unsolicited Acquisition Proposals from third parties (*that are not in breach of the provisions of section 4.4*) (ss. 4.4(2) and 4.4(3)). Thirdly, it contains a series of provisions dealing with how the parties are to address a situation

where a permitted Acquisition Proposal is received (ss. 4.4(3)-4.4(7)).[5] Lastly, s. 4.4(8)(v) returns to the general non-solicitation obligation, reinforcing it by ensuring that Sunrise will (i) ensure all of its officers, Trustees and agents are aware of the non-solicitation provisions, (ii) immediately stop negotiating with anyone previously involved in the bidding process, (iii) require those bidders to return any confidential documentation and information they may have received during the process, (iv) terminate access to the data room by anyone other than Ventas and its representatives, and finally (a reiteration of the requirement set out in s. 4.4(1)):

> (v) not amend, modify, waive or fail to enforce any of the standstill terms or other conditions included in any of the confidentiality agreements between Sunrise REIT and any third parties.

[33] Contrary to the appellants' submissions, however, it is not *any* Acquisition Proposal that the Trustees are free to consider as part of the fiduciary out scenario; it is only an Acquisition Proposal from a third party *that is not in breach of section 4.4 of the Agreement*.

[34] Properly understood in this fashion, then, a reading of s. 4.4 demonstrates that there is no *conflict* between the provisions of ss. 4.4(1)(ii), 4.4(2), 4.4(3) and 4.4(8)(v). The repeated standstill enforcement terms *complement* one another. As the application judge pointed out, the opening phrases of ss. 4.4(2) and 4.4(3) — "notwithstanding anything contained in Section 4.4(1)" — do not have the words "or Section 4.4(8)(v)" added to them. This reinforces the interpretation that s. 4.4(8)(v) is there to clarify that Sunrise's obligation to enforce its Standstill Agreements with third parties is not negated by the fiduciary out clause. An unsolicited proposal by a prior bidder bound by a Standstill Agreement is a proposal that is otherwise in breach of s. 4.4, because it violates s. 4.4(8)(v), and therefore is not immunized by the fiduciary out provisions.

[35] In that sense, contrary to the appellants' submissions, the application judge's reading of the Purchase Agreement does not reduce s. 4.4(8)(v) to simply the functional equivalent of s. 4.4(1)(ii). Nor is it a case of s. 4.4(8)(v) continuing to require the enforcement of a Standstill Agreement even when the fiduciary out clause is otherwise applicable. The fiduciary out clause

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5 The Proposal has to be a Superior Proposal; Sunrise has to notify Ventas of the Proposal and provide it with all relevant documentation; Ventas had the right to match the Proposal within five days (as defined) and, if it chooses not to, to terminate the Agreement and receive the break fee (see also, s. 5.3 and Schedule "B" (definition of "Termination Payment")).

does not apply where the unsolicited proposal is tendered in breach of the non-solicitation provisions of the Purchase Agreement, *i.e.*, in breach of a Standstill Agreement that Sunrise is obliged to enforce. The fiduciary out formula is an important feature of the non-solicitation format, but it does not allow Sunrise to resile from the terms of its Standstill Agreements with earlier bidders, in my opinion.

The difference in wording between sections 4.4(1)(ii) and 4.4(8)(v)

[36] Mr. Howard emphasized what he argued was a difference in wording between those two provisions. He points out that s. 4.4(1)(ii) expressly refers to situations involving "an actual or potential Acquisition Proposal" whereas s. 4.4(8)(v) contains no such reference, and further, that other subsections of s. 4.4(8) — namely, ss. 4.4(8)(ii) and (iii) — refer to Acquisition Proposals as well, although not in the context of standstill agreements (4.4(8)(ii) and 4.4(8)(iii)). Because s. 4.4(8)(v) does not refer to "Acquisition Proposals", Mr. Howard submits it does not apply in the context of such a proposal and therefore does not apply in the context of the HCPI Acquisition Proposal.

[37] There are several problems with this argument. First, it misapprehends the fact that *any* proposal to acquire more than 20 per cent of the assets of Sunrise — whether made before or after the close of the auction — constitutes an "Acquisition Proposal" as defined in the Agreement. Consequently, s. 4.4(8)(v) can only apply in the context of an Acquisition Proposal of some sort, regardless of its wording.

[38] Secondly, the argument appears to be founded on the unarticulated premise that an Acquisition Proposal, as referenced in ss. 4.4(1)(ii), 4.4(2) and 4.4(3), is the equivalent of a Superior Proposal. The appellants' theory of the Agreement is that the Trustees are entitled to consider any Acquisition Proposal received after the close of the auction, and that the commitment in s. 4.4(8)(v) to enforce standstill agreements only applies in the event that a subsequent Acquisition Proposal received by the Trustees does not make the grade as a Superior Proposal. The function of s. 4.4(8)(v), they say, is to permit the Trustees in such circumstances to prevent a bidder in such a case — whether a prior bidder or not — from continuing to participate in the bidding process.

[39] It is not the case, however, that an Acquisition Proposal and a Superior Proposal are the same thing. The latter is a narrower concept than the former. While an Acquisition Proposal is essentially an offer by anyone to acquire more than 20 per cent of

the assets of Sunrise, a Superior Proposal is an Acquisition Proposal[6] that is more favourable to the unitholders from a financial point of view than the Ventas bid. Sunrise submits, at para. 43 of its factum, that s. 4.4(8)(v) "is part of the filtering protection for both Ventas and Sunrise REIT that allows and obliges Sunrise REIT to deal summarily with offers that do not meet the Acquisition Proposal threshold". Sunrise does not mean the "Acquisition Proposal threshold" in this statement, however; it means the "Superior Proposal threshold". To support the appellants' argument, the reference to "Acquisition Proposal" in s. 4.4(1)(ii) would have to be read as "Superior Proposal". That is not what it says.

[40] Moreover, and in any event, a careful reading of s. 4.4(1)(ii) does not bear out the nexus between the reference to "Acquisition Proposal" and the commitment to enforce the standstill agreements. For ease of reference I repeat the wording of s. 4.4(1)(ii) here:

> 4.4(1) Following the date hereof, Sunrise REIT shall not . . .
>
> (ii) participate in any discussions or negotiations in furtherance of such inquiries or proposals or regarding an actual or potential Acquisition Proposal or release any Person from, or fail to enforce, any confidentiality or standstill agreement or similar obligations to Sunrise REIT or any of its Subsidiaries.

[41] Section 4.4(1)(ii) in reality contains two prohibitions, not one. The language does not work otherwise. Sunrise agrees not to participate in discussions or negotiations regarding actual or potential Acquisition Proposals. It also agrees not to release anyone from, or fail to enforce, existing Standstill Agreements. The drafters could well have divided s. 4.4(1) into six general prohibitions rather than five. The commitment to enforce the Standstill Agreements is not, therefore, tied to "Acquisition Proposals" in a way that s. 4.4(8)(v) is not.

[42] Accordingly, I agree with the application judge's observation that while the appellants' interpretation arguments are creative, they are strained. As she said [at para. 39], "They disregard the parties' intention and the true meaning of the subject sections and the Purchase Agreement as a whole."

An interpretation that reflects the "factual matrix", is "commercially sensible", and accords with the fiduciary obligations of the Sunrise trustees

[43] Nor do I accept the submission that the application judge failed to consider the factual matrix underlying the negotiation of

6 That meets the s. 4.4(2) requirements of being *bona fide* and unsolicited.

the Purchase Agreement, or that she failed to give effect to the "commercial sense" component of contract interpretation.

[44] In a blended argument, the appellants submit that the application judge's interpretation of the Purchase Agreement ignores the factual matrix in which the Agreement was negotiated, defies commercial sense and reasonableness, and eviscerates the fiduciary out mechanism that was central to the parties' agreement. Respectfully, I do not read the application judge's reasons in this fashion.

The factual matrix

[45] Contracts are not made in a vacuum, and there is no dispute that the surrounding circumstances in which a contract is negotiated are relevant considerations in interpreting contracts. As this court noted in *Kentucky Fried Chicken, supra*, at para. 25, "[w]hile the task of interpretation must begin with the words of the document and their ordinary meaning, the general context that gave birth to the document or its 'factual matrix' will also provide the court with useful assistance."

[46] Sunrise points to a number of surrounding circumstances which it says the application judge ignored in arriving at her decision. These include that:

(a) the Purchase Agreement was entered into at the conclusion of the second stage of a private sale auction process where it was clear that the overall objective of Sunrise was to maximize value for [its] unitholders;

(b) the expectations of the bidders, objectively determined, could not have been that the "winner" of the auction was assured of acquiring the Sunrise assets, because everyone was aware that there would be a fiduciary out clause and that superior proposals could displace the winning bid;

(c) Ventas's own standstill terms ceased to apply in the event that Sunrise entered into a sales transaction with a third party, and Ventas could not know whether the other Standstill Agreements rested on the same footing (and did not know that HCPI's did not);

(d) Ventas never told Sunrise it believed the participants in the auction would be excluded from the operation of the fiduciary out provision; and

(e) Ventas had bargained for, and achieved, considerable deal protection, in the form of the "no shop" provision, the right

> to match any Superior Proposal, and the right to receive a $39.8 million break fee if it chose not to match such an offer.

[47] Matters involving the factual matrix underlying a contract are matters of fact, or at least matters of mixed fact and law. A judge is owed considerable deference in her assessment of such matters. Here, the experienced Commercial List judge was exercising a function common to that role — the interpretation of a commercial contract — and, while she may not have dealt with the foregoing themes expressly as the appellants would like, her reasons, read as a whole, indicate that she was alive to most, if not all, of them. She was certainly aware of the facts contained in points (a), (b), (c) and (e) above, as she dealt with them at one time or another in the reasons. The factor mentioned in (d) is not dispositive of anything.

[48] At the conclusion of her consideration of the interpretation issue, as noted earlier, the application judge said (at paras. 38 and 39):

> It seems to me that the clear scheme of this Purchase Agreement was [to] ensure enforcement of standstill agreements that had been signed as part of the auction process. This strikes me as being objectively reasonable and was a form of protection afforded to the purchaser, Ventas. *This was part of the package negotiated between it and Sunrise REIT.*
>
> Such an interpretation derives from the words used by the parties to the Purchase Agreement and gives effect to the parties' intention. It is also consistent with *the context of the transaction including the auction process which was the genesis of the Purchase Agreement*. The Purchase Agreement does not preclude *bona fide* written unsolicited Acquisition Proposals nor does it preclude such a proposal from a party whose standstill agreement operated to permit such a proposal. It simply precludes a proposal from anyone else who is in breach of its standstill agreement.

(Emphasis added, footnote omitted)

[49] I can find no basis for concluding the applications judge was not attuned to the need to keep the factual matrix in mind when conducting her interpretative exercise.

[50] Nor do I accept that she either ignored the need to interpret the contract in a way that reflected sound commercial sense, or that she failed to give it such an interpretation. It is apparent from her recitation of the principles of contract interpretation that she was aware of the relevance of the "sound commercial sense" theme. She cited the following passage from this court's decision in *Kentucky Fried Chicken, supra*, at para. 27:

> Where, as here, the document to be construed is a negotiated commercial document, the court should avoid an interpretation that would result in a commercial absurdity: [*Toronto (City) v. W.H. Hotel Ltd.*, [1966] S.C.R. 434, [1966] S.C.J. No. 23, 56 D.L.R. (2d) 539, at p. 548 D.L.R.]. Rather, the document should be construed in accordance with sound commercial principles

> and good business sense: [*Scanlon v. Castlepoint Development Corporation* (1992), 11 O.R. (3d) 744, [1992] O.J. No. 2692 (C.A.), at p. 770 O.R.]. Care must be taken, however, to do this objectively rather than from the perspective of one contracting party or the other, since what might make good business sense to one party would not necessarily do so for the other.

[51] The appellants' argument that the application judge failed to interpret the Purchase Agreement in a fashion that accords with sound commercial sense is grounded in the belief that she overlooked the importance of the "maximizing value" principle and the centrality of the Trustees' fiduciary obligations in that regard, in cases of this nature. She did neither, in my view.

[52] As noted above, the application judge was sensitive to the fiduciary out provisions that permitted other *bona fide* written unsolicited Acquisition Proposals. In her view, however, this was balanced, objectively and reasonably, by the requirement that Sunrise ensure enforcement of Standstill Agreements that had been signed as part of the auction process in order to protect the successful bidder. This interpretation makes commercial sense, in my view.

[53] On behalf of HCPI, Mr. Leon placed great emphasis on the sanctity of the fiduciary out mechanism in acquisition agreements of this nature. There is no doubt that the directors of a corporation that is the target of a takeover bid — or, in this case, the Trustees — have a fiduciary obligation to take steps to maximize shareholder (or unitholder) value in the process: see *CW Shareholdings Inc. v. WIC Western International Communications Ltd.* (1998), 39 O.R. (3d) 755, [1998] O.J. No. 1886 (Gen. Div.), at pp. 768 and 774 O.R. That is the genesis of the "fiduciary out" clauses in situations such as the case at hand. They enable directors or trustees to comply with their fiduciary obligations by ensuring that they are not precluded from considering other *bona fide* offers that are more favourable financially to the shareholders or unitholders than the bid in hand.

[54] It is not necessary — nor would it be wise, in my view — to go as far as HCPI suggests this court might go, and adopt the principle gleaned from some American authorities, that the target vendor can place no limits on the directors' right to consider superior offers and that any provision to the contrary is invalid and unenforceable: see *Paramount Communications, Inc. v. QVC Network Inc.*, 637 A. 2d 34 (Del. 1994), and *ACE Ltd. v. Capital Re Corp.*, 747 A. 2d 95 (Del. Ch. 1999), at p. 105. That is not what happened in this case.

[55] The Trustees did not contract away their fiduciary obligations. Rather, they complied with them by setting up an auction process, in consultation with their professional advisers, that was designed to maximize the unit price obtained for Sunrise's

assets, in a fashion resembling a "shotgun" clause, by requiring bidders to come up with their best price in the second round, subject to a fiduciary out clause that allowed them to consider superior offers from anyone save only those who had bound themselves by a Standstill Agreement in the auction process not to make such a bid. In this case, that turned out to be only HCPI.

[56] An auction process is well-accepted as being one — although only one — "appropriate mechanism to ensure that the board of a target company acts in a neutral manner to achieve the best value reasonably available to shareholders in the circumstances": *Maple Leaf Foods Inc. v. Schneider Corp.* (1999), 42 O.R. (3d) 177, [1999] O.J. No. 4142 (C.A.), at p. 200 O.R. Here, the trustees, acting reasonably and on professional advice, formed the view that an auction process was the best way to maximize value, and conducted such an auction to the point where they attracted a successful bidder. This is not a case where the Trustees were unable to judge the adequacy of the bid (*Schneider*, at p. 200 O.R.). They had dealt with seven prospective purchasers in the course of the two auction rounds, and had received preliminary proposals. Ventas's $15-per-unit price represented a 35.8 per cent increase over the market price of the Units on the date the auction closed. I do not think the Trustees can be said to have failed in the exercise of their fiduciary obligations to their unitholders in these circumstances simply by agreeing in the Purchase Agreement to preclude earlier bidders, who had bound themselves under Standstill Agreements not to do so, from coming in after the auction was concluded and the "successful" bidder had showed its cards and attempting to "top up" that bid.

[57] It is well accepted that "where an agreement admits of two possible constructions, one of which renders the agreement lawful and the other of which renders it unlawful, courts will give preference to the former interpretation": John D. McCamus, *The Law of Contracts* (Toronto: Irwin Law, 2005) at p. 729. Advancing this principle, the appellants argue that we should be loath to adopt an interpretation of the Purchase Agreement that is inconsistent with overarching fiduciary obligations. While I accept the principle put forward, however, I do not think it applies in the context of this case for the reasons outlined above. The interpretation given to the Purchase Agreement by the application judge is not inconsistent with the Trustee's fiduciary obligation to maximize unitholder value. Indeed, it is consistent with that obligation.

[58] Finally, Mr. Leon emphasizes the importance of the word "nothing" in the opening language of ss. 4.4(2) and 4.4(3) of the Purchase Agreement. Both provisions open with the words

"Notwithstanding anything contained in Section 4.4(1), until the Unitholder Approval, *nothing* shall prevent the Board from . . ." (emphasis added). Mr. Leon submits that "nothing" means what it says, and must be given the full scope of that meaning, in order to ensure that "nothing" in the Purchase Agreement or otherwise is permitted to stand in the way of the Trustees performing their duty to maximize shareholder value. This point involves parsing the Purchase Agreement in a microscopic fashion that is a little too fine, in my view. The use of the word "nothing" in ss. 4.4(2) and 4.4(3) is nothing more than a different way of saying "Notwithstanding anything contained in Section 4.4(1) . . . *the Board is not prevented from* . . .". I would not ascribe to it the expanded role that HCPI proposes.

The meaning of "bona fide"

[59] The appellants also attack the conclusion of the application judge that the HCPI Acquisition Proposal was not a "*bona fide*" offer. She accepted the Ventas submission that "a proposal made in breach of a contractual obligation not to make such a proposal cannot be considered to be *bona fide*", noting that ss. 4.4(2) and 4.4(3) of the Purchase Agreement contemplate an Acquisition Proposal from a third party "that did not result from a breach of . . . Section 4.4".

[60] There was much debate about the meaning of "*bona fide*". The application judge viewed it as meaning acting "in good faith; sincere, genuine", relying upon *The Oxford English Dictionary*.[7] She found that the HCPI Acquisition Proposal was not *bona fide* because it was made in breach of the HCPI Standstill Agreement, which Sunrise was obliged by s. 4.4 to enforce. The appellants agree that *bona fide* means "genuine" or "made in good faith", but submit that a *bona fide* Acquisition Proposal, as contemplated by the Purchase Agreement, is one that is "genuine" or "authentic" in the sense that it is not a sham and is reasonably capable of becoming a Superior Proposal, and that this decision must be made in the context of the entire situation.

[61] In the end, there is not much difference between the parties as to the meaning of the term "*bona fide*". As with the principles of contract interpretation, they differ on the application of the term in the circumstances of this case. Given the language of the Purchase Agreement, and the context in which it was negotiated — particularly the language "that did not result from a breach of this Section 4.4" in ss. 4.4(2) and 4.4(3) — I do not think

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7 2d ed., *s.v.* "bona fide".

the application judge erred in her assessment and use of the term "*bona fide*" here.

Miscellaneous

[62] Two additional points were made by the appellants, but need not be dealt with at length.

[63] First, HCPI argued that Sunrise had given its prior consent to HCPI to make its subsequent Acquisition Proposal following completion of the auction process and the execution of the Purchase Agreement. This consent is said to derive from the waiver Sunrise gave to both HCPI and Ventas as part of the invitation to bid in the second round. The application judge made a specific finding against this position, however, concluding that the December 29, 2006 letter "cannot possibly be construed as constituting Sunrise REIT's prior written consent as that term is used in the Standstill Agreement". There is no basis for interfering with this finding.

[64] Secondly, HCPI submitted that the position of Ventas on these applications was tantamount to saying that the benefit of the HCPI Standstill Agreement had been assigned to it. The application judge correctly found that there was no merit in this argument. I agree with her that neither the Standstill Agreement nor its benefits had been assigned to anyone, and no one was taking the position that they had.

The HCPI Cross-Appeal

[65] HCPI applied for a declaration that communications between it and SSL regarding Sunrise were permitted. The application judge declined to deal with this request, given her ruling which effectively precluded the HCPI Acquisition Proposal from being pursued. She concluded the application was moot.

[66] I agree and for the same reason find it unnecessary to deal with the cross-appeal for the same relief.

Conclusion

[67] For the foregoing reasons, then, I would dismiss both the appeal and the cross-appeal.

[68] If the parties are unable to agree as to costs, they may make brief written submissions in that regard, not to exceed five pages in length.

[69] In closing, I would like to thank all counsel for their able presentations and assistance.

Appeal dismissed.

TAB "17"

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BANKRUPTCY & INSOLVENCY LAW

Roderick J. Wood

ESSENTIALS OF CANADIAN LAW

ESSENTIALS OF
CANADIAN LAW

BANKRUPTCY AND INSOLVENCY LAW

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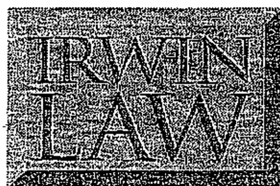

Under the *CCAA*, the onus was on a creditor to bring its objection to the proposed classification of claims before the court. However, in many restructurings the company would apply to court for an order approving the classification scheme. The 2005/2007 amendments have codified this practice. The *CCAA* now provides that the debtor must apply to court for approval of a classification scheme for voting at a meeting.[90]

E. THE TREATMENT OF SHAREHOLDER CLAIMS

1) Shareholder Approval of Fundamental Changes

The *BIA* and the *CCAA* deal only with voting on a plan by creditors, and do not make any provision in respect of shareholders. The *CCAA* provides that the provisions of the Act may be applied together with the provisions of any federal or provincial legislation that authorizes or makes provisions for the sanction of compromises or arrangements between a company and its shareholders.[91] The *BIA* does not contain a comparable provision. Both the *CCAA* and the *BIA* provide that a court may order that the constating instrument be amended to reflect any change that can be lawfully made under federal or provincial law.[92]

The restructuring plan may involve a sale of substantially all the assets to a purchaser. The corporate law that governs the debtor corporation may provide that shareholder approval is required before the transaction can be completed. Alternatively, the restructuring plan may involve a change to the articles of incorporation, an amalgamation, or some other fundamental change that requires the approval of the shareholders. The question that arises is whether shareholder approval is needed to implement the restructuring plan.

If shareholder approval is needed, the shareholders will generally be able to receive some consideration or maintain some participation in the restructured corporation as the price for obtaining their consent to the transaction. If shareholder approval is not needed, the restructuring may eliminate their claims on the basis that they are of no economic value. The latter approach is the one that has been embraced by the courts.

Many of the Canadian corporation statutes, such as the *Canada Business Corporations Act*,[93] provide that a court may make an order

90 *CCAA*, above note 3, s. 22(1).

91 *Ibid.*, s. 42.

92 *Ibid.*, s. 6(2); *BIA*, above note 3, s. 59(4).

93 R.S.C. 1985, c. C-44, s. 191. See also Alberta *Business Corporations Act*, R.S.A. 2000, c. B-9, s. 192; Ontario *Business Corporations Act*, R.S.O. 1990, c. B.16, s. 186.

amending a corporation's articles of incorporation in connection with a restructuring under the *CCAA* or the *BIA*. The legislation further provides that shareholders do not have a right of dissent. This permits a court to cancel the existing shares in respect of the restructured company.[94]

Other corporation statutes do not contain similar provisions, and courts have been called upon to decide whether the provisions of the corporation legislation that require shareholder approval of fundamental changes must be satisfied. In *Re Loewen Group Inc.*,[95] the court held that the provisions of the corporations statute requiring shareholder approval are inapplicable in cases where the disposition is pursuant to a vesting order issued pursuant to the *CCAA*.

A further issue is whether the same approach can be applied in respect of restructuring proceedings under the *BIA*. This issue was addressed in *Fiber Connections Inc. v. SVCM Capital Ltd.*[96] The court came to the conclusion that shareholder approval was not required for two reasons. First, a court could resort to the oppression remedy to override the veto power that could otherwise be exercised by a shareholder whose shares have no economic value. Second, a court may draw upon its inherent jurisdiction to make such orders. Although it was acknowledged that there is much less scope for the use of the concept in connection with the more detailed rule-based approach of the *BIA*, the court held that it may be invoked to permit a court to make an order setting aside a unanimous shareholder agreement and amending the share structure of the debtor corporation.

Although courts have not hesitated to eliminate shareholder equity in restructuring proceedings where it is obvious that the interest of shareholders is clearly of no economic value, the same approach should not be applied where there is legitimate uncertainty or disagreement over the going-concern value of the firm. If there is a reasonable possibility that the interests of the shareholders retain some value, the shareholders may legitimately expect to participate in the restructuring.

2) The Treatment of Equity Claims

Shareholders are on the very bottom rung in the scheme of priorities. They are not entitled to anything until the claims of creditors are fully satisfied. Shareholders have attempted to enhance their low status by

94 *Re Stelco Inc.* (2006), 17 C.B.R. (5th) 78 (Ont. S.C.J.); *Re Beatrice Foods Inc.* (1996), 43 C.B.R. (4th) 10 (Ont. Ct. Gen. Div.).

95 (2001), 32 C.B.R. (4th) 54 (Ont. S.C.J.).

96 (2005), 10 C.B.R. (5th) 192 (Ont. S.C.J.).

TAB "18"

[Indexed as: **Calpine Canada Energy Ltd., Re**]

In the Matter of the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as Amended

And in the Matter of Calpine Canada Energy Limited, Calpine Canada Power Ltd., Calpine Canada Energy Finance ULC, Calpine Energy Services Canada Ltd., Calpine Canada Resources Company, Calpine Canada Power Services Ltd., Calpine Canada Energy Finance II ULC, Calpine Natural Gas Services Limited, and 3094479 Nova Scotia Company (Applicants)

Alberta Court of Queen's Bench

B.E. Romaine J.

Heard: January 22, 2007

Judgment: February 8, 2007

Docket: Calgary 0501-17864, 2007 ABQB 49

Larry B. Robinson, Q.C., Sean I. Collins, Fred Myers, Jay A. Carfagnini, Brian Empey for CCAA Debtors

Patrick McCarthy, Q.C., Josef A. Krueger for Monitor

A. Robert Anderson, Q.C., Kevin P. McElcheran (present by telephone) for Independent Trustees of Calpine Commercial Trust

John Finnigan, Robert Thornton for ULC2 Ad Hoc Committee of Bondholders

Sean Dunphy, Elizabeth Pillon for ULC2 Trustee

Frank Dearlove for HSBC Bank

Howard Gorman, Randal Van de Mosselaer for ULC1 Noteholders

Peter H. Griffin for Calpine Corporation and other U.S. Debtors

Peter T. Linder, Q.C., Emi R. Bossio for HCP Acquisition Inc.

Richard Billington for Catalyst Capital Group Inc.

Glenn Solomon for certain creditors

Bankruptcy and insolvency — Proposal — Companies' Creditors Arrangement Act — Arrangements — Approval by court — Miscellaneous issues — Corporation went into receivership — Corporation had closely intertwined relationship with commercial trust and income fund — Group representing corporation sought to sell various assets relating to such relationship between entities, including certain trust units — Group reached settlement agreement with fund and applied for order approving of such agreement — Receiver received offer from third party for trust units — Court directed monitor to prepare report comparing third party offer and settlement agreement — Monitor initially advised that settlement agreement be accepted — Following complaints by certain stakeholders and creditors, court directed monitor to create new report considering new offer put forth by third party — Monitor advised that third party's new offer be accepted — Group brought application for approval of third party's offer — Application granted — Best interests of all parties would not be served by continuation of process in

search of better offers — Potential for increased consideration was outweighed by risks and potential delay that would follow — Final recommendation of monitor was sound and reasonable — Rejection of recommendations in any but most exceptional circumstances materially diminished and weakened role and functions of receiver — Such casual rejection would lead to conclusion that decision of receiver was of little weight and that real decision was always made by court upon application for approval — Third party's final offer was only route which assured avoidance of prolonged litigation.

Cases considered by *B.E. Romaine J.*:

Crown Trust Co. v. Rosenberg (1986), 60 O.R. (2d) 87, 1986 CarswellOnt 235, 22 C.P.C. (2d) 131, 39 D.L.R. (4th) 526, 67 C.B.R. (N.S.) 320 (note) (Ont. H.C.) — followed

Royal Bank v. Soundair Corp. (1991), 7 C.B.R. (3d) 1, 83 D.L.R. (4th) 76, 46 O.A.C. 321, 4 O.R. (3d) 1, 1991 CarswellOnt 205, [1991] O.J. No. 1137 (Ont. C.A.) — followed

Salima Investments Ltd. v. Bank of Montreal (1985), 41 Alta. L.R. (2d) 58, 21 D.L.R. (4th) 473, 65 A.R. 372, 59 C.B.R. (N.S.) 242, 1985 CarswellAlta 332 (Alta. C.A.) — considered

Statutes considered:

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
Generally — referred to

Courts of Justice Act, R.S.O. 1990, c. C.43
Generally — referred to

APPLICATION by group for approval of third party's offer to purchase trust units.

***B.E. Romaine J.*:**

Introduction

1 These reasons describe the complicated and controversial course of an application to sell certain assets. The application was made by the above-noted applicants (collectively, the "Calpine Applicants"), who, pursuant to an initial order dated December 20, 2005, are under the protection of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "CCAA").

Facts

2 This saga began when the Calpine Applicants decided to attempt to sell certain assets that form part of the complex, intertwined relationship of Calpine Canada Power Ltd. ("CCPL") with the Calpine Commercial Trust (the "Trust") and the Calpine Power Income Fund (the "Fund").

3 On December 21, 2006, the Calpine Applicants filed a Notice of Motion, returnable on December 28, 2006, seeking authorization to market and sell the following assets (the "Fund-related Assets"):

a) certain contracts, being a management agreement, an administration agreement and some operating agreements (collectively, the

"MA&O Agreements") relating to the Fund, the Trust and Calpine Power L.P. ("CLP") and to the operation of two power plants owned by CLP; and

b) the Class B Units in CLP.

4 An affidavit sworn on December 21, 2006 by Toby Austin, President and CEO of CCPL, includes at para. 10 a simplified diagram of the structure of CCPL's relationship with the Fund, the Trust and CLP.

5 Briefly, CLP is a limited partnership with Calpine Power L.P. Ltd. ("CLPGP") as its general partner and the Trust and CCPL as limited partners. CLPGP has assigned its rights and obligations as a general partner to CCPL. The Trust is an open-ended trust, the sole beneficiary of which is the trustee of the Fund. The Fund is a publicly held income fund listed on the TSX. Since CCPL and the other Canadian Calpine entities sought the protection of the CCAA, the Trust and the Fund have been governed by the independent trustees of the Trust and the independent directors of CLPGP (who are also trustees).

6 The Trust's principal asset is its interest in CLP. CLP indirectly owns two power plants, the Island Cogen Facility in British Columbia and the Calgary Energy Centre. CLP granted a participating unsecured loan to Calpine Canada Whitby Holdings Company, an entity that owns 50% of a joint venture that is developing a cogeneration facility in Ontario.

7 The Trust owns A Units in the CLP limited partnership. CCPL owns B Units. The B Units, which represent 30% of the equity of CLP, are subordinate to the A Units. Further complicating this already intertwined relationship, the Trust purchased from CCPL in May 2004 a promissory note with a face value of approximately $53.5 million pursuant to a loan known as the Manager's Loan. As security for the Manager's Loan, CCPL granted to the Trust a pledge of the B Units.

8 CCPL administers the Fund and the related entities pursuant to the MA&O Agreements. The MA&O Agreements all provide that they may be assigned by CCPL only with the consent of either the Trust or CLP, which consent shall not be unreasonably withheld. In support of their motion for authorization to sell the Fund-related Assets, the Calpine Applicants advised that on December 19, 2006, Harbinger Capital Partners ("Harbinger") had announced its intention to launch a take-over bid for the publicly-traded trust units of the Fund and that the Calpine Applicants believed that this presented them with an opportunity to negotiate the sale of the Fund-related Assets with bidders who might be interested in acquiring the Fund.

9 In response to the Calpine Applicants' motion, the Fund advised that it intended to bring a cross-application to terminate the MA&O Agreements. The Christmas break intervened and the application and proposed cross-application were adjourned to a date in January 2007. The Fund was to circulate materials with respect to its cross-application by Friday, January 12, 2007.

10 During the days leading up to and including Saturday, January 13, 2007, the Fund and the Calpine Applicants negotiated and entered into a settlement agreement (the "Settlement Agreement"). A notice of motion and supporting affidavit with respect to this Settlement Agreement was circulated to the service list on January 13 and 14, 2007. The Calpine Applicants applied for an order:

a) authorizing CCPL to enter into the Settlement Agreement;

b) approving the Settlement Agreement and the various transaction agreements that accompanied it;

c) terminating the MA&O Agreements upon the closing of the Settlement Agreement and lifting the stay of proceedings under the CCAA proceedings for that limited purpose;

d) directing that a confidential supplemental report on the Settlement Agreement that was to be prepared by Ernst & Young Inc. (the "Monitor") be sealed until closing of the Settlement Agreement; and

e) miscellaneous other relief.

11 The Fund prepared a Notice of Motion bearing the same date in which the independent trustees of the Trust and the directors of CLPGP applied to lift the stay imposed under the CCAA for the purpose of terminating the MA&O Agreements if the Settlement Agreement was not approved by the Court. The motion to approve the Settlement Agreement was to be heard on Wednesday, January 17, 2007.

12 On Monday, January 15, 2007, I heard from various stakeholders in this CCAA proceeding who were aggrieved about both the timing of the application and the stringent requirements of confidentiality that had been imposed by the Fund on information relating to the Settlement Agreement. That day was a holiday in the United States where a number of stakeholders are resident and several counsel had been unable to receive instructions from their clients on these issues. I directed that the application to approve the Settlement Agreement be set over to Monday, January 22, 2007 and that the issue of the terms of confidentiality be adjourned to Wednesday, January 17, 2007 so that counsel could obtain adequate instructions from their clients.

13 Late on January 16, 2007, the Monitor received an offer (the "Harbinger Offer") for the Fund-related Assets from HCP Acquisition Inc. ("HCP"), the subsidiary of Harbinger that is the vehicle for Harbinger's take-over bid for the public Trust units. The Monitor provided the Court with a copy of the offer, together with an application for advice and directions, shortly before Court opened to hear submissions on the confidentiality issue. The Harbinger Offer for the Fund-related Assets was publicly disclosed by press release, but most parties had only recently become aware of its terms. The Monitor, of course, was not in a position at that time to provide advice on the offer and how it compared to the

terms of the Settlement Agreement. It became apparent during the course of the hearing that the stakeholders wanted the Monitor to prepare a comparison of the Settlement Agreement and the Harbinger Offer. Submissions from that point focussed on how much, if any, of the Monitor's report with respect to that comparison should be subject to confidentiality, and whether the confidentiality provisions imposed by the Fund on the Settlement Agreement and on the Monitor's Supplemental Report (as defined below) should be lifted. Some stakeholders argued vigorously for a different process more akin to an open auction or tender for the assets.

14 At this point, the Monitor had prepared two reports, a Sixteenth Report that discussed the Settlement Agreement in general terms, without disclosing its specific financial terms, which was disclosed without restriction to the service list, and a Supplemental Report to the Sixteenth Report (the "Supplemental Report") that disclosed those financial terms, together with the Monitor's comments on the value of the MA&O Agreements and the B Units. These latter comments included a review of CCPL's discounted cash flow financial model of the B Units. The Supplemental Report was made available only to stakeholders who entered into confidentiality agreements as required by the Settlement Agreement.

15 The Calpine Applicants and the Fund submitted that the Settlement Agreement and the Supplemental Report were confidential and commercially sensitive to both parties. The Calpine Applicants were concerned that pricing and valuation information contained in the Supplemental Report would have a negative impact on any subsequent marketing process if the Settlement Agreement was not approved. The Fund had concerns relating to its response to the Harbinger take-over bid of the publicly-traded trust units and submitted that disclosure of the pricing and financial terms could be used by Harbinger to the disadvantage of the Fund. The Fund also asserted strenuously that it did not want to be placed in the position of a stalking horse for the Fund-related Assets and that, if it was put in that position, it would withdraw its offer.

16 The parties who sought access to the terms of the Settlement Agreement and the Supplemental Report were offered certain choices of confidentiality agreements, but it is clear that the Fund sought to ensure that such parties would be precluded from using the information for any purpose other than evaluating the Settlement Agreement, and particularly from making any kind of competing bid for the Fund's public trust units. One version of confidentiality agreement proffered by the Fund allowed stakeholders to establish an internal confidential screen that would remain in effect for two years in order to evaluate the information without requiring confidentiality to be imposed on the stakeholder's entire organization. Another allowed legal advisors to review the material without allowing them to disclose confidential terms to their clients. Although an attempt to impose this degree of restriction on access to information is exceptional in litigation generally, it is not without precedent in cases involving CCAA pro-

ceedings and receivers where assets of a business are sought to be sold: See In the matter of a Plan of Compromise and Arrangement of Air Canada, *et al.*, under the CCAA, R.S.C. 1985, c. C-36, as amended; see also In the matter of the CCAA, R.S.C. 1985, c. C-36, as amended, and In the Matter of the Courts of Justice Act, R.S.O. 1990 c. C-43, as amended and In the Matter of a Plan of Compromise or Arrangement of Royal Oak Mines, *et al.* (all unreported).

17 I concluded that, although the Settlement Agreement was negotiated under stringent terms of confidentiality and the Supplemental Report was prepared pursuant to an assumption of confidentiality and on the assumption that the likelihood of CCPL receiving any offers whose benefits to CCPL exceeded those of the Settlement Agreement was remote, the situation had changed with the introduction of the Harbinger Offer. I was concerned, however, that it could be prejudicial to the primary goal of maximizing value to stakeholders if I ordered unrestricted disclosure of the Settlement Agreement or of the Supplemental Report during the short period of time between January 17 and January 22, 2007, when the Monitor's new report comparing the offers became available, particularly if I determined after hearing full submissions on January 22, 2007 that a different process should be followed.

18 I therefore declined either to endorse the confidentiality provisions imposed by the Fund to that date or to order greater disclosure, on the basis that the fairness of the process that led to the Settlement Agreement and the confidentiality requirements that had been imposed by it were live issues for submissions on January 22, 2007 and would be factors in any decision on whether or not to approve the Settlement Agreement. I directed the Monitor to prepare its comparison report with the analysis of the Settlement Agreement remaining subject to restricted disclosure, but with the Monitor's conclusions and recommendations being available on an unrestricted basis to stakeholders. I asked the Monitor to address the issue of whether a broader auction or marketing process should be undertaken.

19 The Monitor's Seventeenth Report was prepared and circulated on Friday, January 19, 2007. The Monitor concluded that, taking into account the material variables affecting the comparison between the Harbinger Offer and the Settlement Agreement, the completion of the Settlement Agreement proposal was the prudent approach. The Monitor stipulated, however, that the Calpine stakeholders should have the benefit of the Seventeenth Report and that the Monitor and the Court "should consider the stakeholders' tolerance for increased risk and potentially incremental realizations for the Fund-related Assets when considering the motion to approve the [Settlement Agreement] on January 22, 2007."

20 The Monitor considered two broad options, the completion of the Settlement Agreement and an auction marketing process. The Monitor noted that the Fund had advised the Court that it would not participate in an auction process and had indicated that, if the Settlement Agreement was not approved on January 22,

2007, it would proceed on January 26, 2007 with its motion to terminate the MA&O Agreements. If the Fund removed itself from the auction process, there would be no competitive tension with the Harbinger Offer unless other parties came forward. The Monitor believed that a limited number of new parties would be available to participate in an auction process because parties who might otherwise be interested might have become restricted in submitting an offer because of participation in the Fund's efforts to find a "white knight" with respect to the Harbinger take-over bid for the Fund public trust units. The Monitor pointed out that the B Units are an illiquid, subordinated minority position in a private entity, attractive primarily to parties who may be interested acquiring the Fund. He also noted that the Harbinger Offer could be terminated at any point prior to acceptance. Given all of these factors, the Monitor believed there was substantial risk in pursuing an auction process.

21 On the morning of January 22, 2007, shortly before the motion to approve the Settlement Agreement was heard, Harbinger submitted a revised offer for the Fund-related Assets (the "Harbinger Revised Offer") that increased the price offered from the greater of $100 million or the value of the Settlement Agreement transaction price plus $2 million, as set out in the Harbinger Offer, to the greater of $110 million and 110% of the value of the Settlement Agreement transaction price. The Harbinger Revised Offer also removed Harbinger's ability to withdraw the offer without the Monitor's permission before the earlier of:

a) February 16, 2007;

b) Court approval of an alternate proposal; and

c) Harbinger making a replacement offer that the Monitor concludes is superior to the Harbinger Revised Offer.

22 At the hearing, the Ad Hoc Committee of ULC II Bondholders, which includes Harbinger as a member, and the ULC II Indenture Trustee were in vehement opposition to the motion to approve the Settlement Agreement, suggesting that the process that led to the Settlement Agreement and the restrictions on access to financial information imposed by the Fund had resulted in a "fatally flawed secret marketing process" that placed the stakeholders and the Court in an untenable position. In answer to the Monitor's suggestion that the Court hear from the stakeholders regarding their tolerance for increased risk and potentially incremental realizations for the Fund-related Assets, the Ad Hoc Committee advised that its members, absent Harbinger, had conferred and that "they are prepared to forego the secret benefits of the Settlement Agreement and either take their chances with a properly supervised process, or if need be, revert to the status quo where the marketing of this asset had not yet been commenced." Counsel for the ULC II Bondholders and Trustee submitted that an expedited sales process should be conducted, and that there was still time, given the status of the Harbinger take-over bid, for there to be an auction between the two existing bidders.

23 The Ad Hoc Committee of the ULC II Bondholders and the ULC II Indenture Trustee were the only major creditor group who had not entered into a form of confidentiality agreement with CCPL and the Trust so as to obtain access to the financial terms of the Settlement Agreement and the restricted portions of the Monitor's reports. As noted by counsel, the ULC II Bondholders are in the business of trading in distressed bonds, and the possession of non-public information relating to the B Units would preclude them from trading in any Calpine securities until the information became public. While the alternatives offered by CCPL and the Trust would allow counsel to the Bondholders to evaluate the Settlement Agreement with a view to the interests of their clients, it would not allow them direct access to information without the unpalatable result to their business of restricting their freedom to trade in Calpine securities. Thus, for this group of stakeholders, anything less than full public disclosure of information about the B Units would be problematic. This placed these creditors in direct conflict with the Trust and the Fund in their efforts to maintain confidentiality of commercially-sensitive information and to avoid becoming a "stalking-horse" for higher offers. While neither of these private commercial interests is of primary significance to this Court in the context of CCAA proceedings, which have as a primary goal the maximization of value of the debtors' assets for the benefit of stakeholders as a whole, they are factors to be weighed in a determination of the fairness and integrity of the sale process.

24 Counsel for the Ad Hoc ULC I Noteholders Committee, who had access to all information relating to the Settlement Agreement through a "counsel's eyes only" confidentiality agreement, noted that his clients were in favour of a short auction between the Fund and Harbinger, with the Fund publicly releasing the details of the Settlement Agreement.

25 Harbinger submitted that the Harbinger Revised Offer addressed a number of the Monitor's concerns, including the elimination of the right to withdraw the offer at any time prior to acceptance, and called for an open auction/marketing process for the assets.

26 The Fund pointed out that eighteen creditors or creditor groups had signed a form of confidentiality agreement, leaving only the ULC II Bondholders and the ULC II Indenture Trustee among the major creditors who had not had access to the financial terms of the Settlement Agreement and the restricted portions of the Monitor's Reports. It "strongly objected" to the marketing of the MA&O Agreements and set out the requirements it indicated it would insist that an assignee of those agreements and a purchaser of the B Units must fulfill if the Settlement Agreement was not approved.

27 When it became apparent that the Settlement Agreement likely would not be approved on the day of hearing, counsel for the Fund noted that the Settlement Agreement expired at midnight on January 23, 2007 and he could not indicate if the independent trustees and directors would extend the deadline or would let

the Settlement Agreement lapse. He stated that the Fund would not participate if the process became an auction. Counsel for the Fund suggested that the terms of the Settlement Agreement be disclosed to all parties other than Harbinger for a very brief period of two hours that day, after which the Monitor would prepare a supplemental report on any additional offers that this disclosure would generate overnight, with the hearing continuing the next day. The Calpine Applicants pointed out that they were bound to support the Settlement Agreement and that they, too, were reluctant to prolong the process beyond the time the Settlement Agreement would expire, as they feared losing the benefits of that agreement.

28 This one-day proposal, which excluded Harbinger, was characterized by the ULC II Bondholders group and the ULC I Noteholders group as being unworkable and wholly ineffective in maximizing value. Harbinger, through its counsel, suggested that the process required at least 10 days, the creation of a data room and a general invitation to bidders.

29 The duties a court must perform when deciding whether a receiver has acted appropriately in selling an asset are summarized succinctly in *Royal Bank v. Soundair Corp.* (1991), 7 C.B.R. (3d) 1, 4 O.R. (3d) 1, 83 D.L.R. (4th) 76, 46 O.A.C. 321 (Ont. C.A.) at para. 16 as follows:

> 1. It should consider whether the receiver has made a sufficient effort to get the best price and has not acted improvidently.
> 2. It should consider the interests of all parties.
> 3. It should consider the efficacy and integrity of the process by which offers are obtained.
> 4. It should consider whether there has been unfairness in the working out of the process.

While the *Soundair* case involved a receivership and this is a situation of a debtor-in-possession under the CCAA overseen by a Monitor, these duties remain relevant to the issues before me, with some adaptation for the differences in the form of proceedings. It is noteworthy that *Soundair* did not suggest that a formal auction process was necessary or advisable in every case, and the Court in fact referred to *Salima Investments Ltd. v. Bank of Montreal* (1985), 59 C.B.R. (N.S.) 242, 41 Alta. L.R. (2d) 58, 65 A.R. 372, 21 D.L.R. (4th) 473 (Alta. C.A.), where the Alberta Court of Appeal suggests that a court on an application to approve a sale is not necessarily bound to conduct a judicial auction.

30 I have no doubt that in negotiating the Settlement Agreement with the Fund, the Calpine Applicants made efforts to get the best price possible, and that they did not act improvidently. While there were submissions to the contrary, it is telling that the Monitor was prepared to recommend the Settlement Agreement despite the lack of negotiation with parties other than the Fund, due primarily to the unique and difficult character of the Fund-related Assets and the backdrop of the Harbinger take-over bid for the Fund's public trust units, which created a time-limited window of opportunity. I also am not persuaded that the Settlement

Agreement was not responsive to the interests of all parties, particularly to the primary interest of the creditors in maximizing value, given the circumstances facing the Calpine Applicants at the time the Settlement Agreement was negotiated.

31 There was, however, a lack of sufficient transparency and open disclosure, which resulted in a process lacking the degree of integrity and fairness necessary when the court is involved in a public sale of assets under the CCAA. The CCAA insulates a debtor from its creditors for a period of time to allow it to attempt to resolve its financial problems through an acceptable plan of arrangement. It allows the debtor to carry on business during that period of time and to exercise a degree of normal business judgment under the supervision of the court and a Monitor. What may be commercially reasonable and even advantageous when undertaken by parties outside the litigation process, however, may be restricted by the requirement that fairness be done, and be seen to be done, when the process is supervised by the court. While a more open process may not lead to greater value, and may, as in this case, give rise to the possibility that an existing bidder may exit the process, the nature of a court-supervised process demands a process that meets at least minimal requirements of fairness and openness. The process undertaken to the point of the hearing on January 22, 2007, particularly with its emphasis on control of information and confidentiality for the primary benefit of the Fund, did not pass the test.

32 In addition, the fact of the Harbinger Offer necessitated closer consideration of the Monitor's assumption, reasonable as it may have been at the time it was made, that the likelihood that the Calpine Applicants would receive any offers that would exceed the benefits to CCPL of the Settlement Agreement was remote.

33 I concluded that circumstances had conspired to produce a situation that was neither fish nor fowl, a kind of lop-sided auction where different bidders were privy to different information and bound by different constraints. What had already occurred could not be changed, but a different process was required from that point forward. While there were differences of opinion as to how much time was available to conduct a sales process with an acceptable degree of integrity, it was necessary that such process be conducted quickly, given the circumstances affecting the two interested bidders. It appeared clear that it would be to the benefit of all stakeholders if the process were accelerated. I decided that an abbreviated sales process was necessary in order to balance the competing requirements of fairness, speed imposed by external circumstances and protection of *bona fide* proprietary or commercially-sensitive information.

34 While not dismissing the application to approve the Settlement Agreement, I directed that:

a) the Monitor issue its Eighteenth Report which would disclose the financial terms of the Settlement Agreement to all stakeholders, including HCP, by noon on January 23, 2007;

b) offers for the Fund-related Assets were to be submitted to the Monitor by noon on Thursday, January 25, 2007;

c) the Monitor would issue its Nineteenth Report comparing offers received by 2:00 p.m. on Friday, January 26, 2007; and

d) the hearing would resume on Tuesday, January 30, 2007.

35 These time limits were later changed by agreement of affected parties so that final offers were to be received by noon on Friday, January 26, 2007 and the Monitor would issue its Nineteenth Report by noon on Saturday, January 27, 2007.

36 I directed that HCP would be able to meet and discuss issues relating to its offer with the Monitor and/or, if the Fund decided not to extend the Settlement Agreement, the Calpine Applicants.

37 I did not release the Supplemental Report generally, on the basis that it had been prepared in the scenario of a single offer and on the assumption of confidentiality. Nor did I release the confidential portion of the Monitor's Seventeenth Report, which had been superceded by events.

38 The Monitor issued its Nineteenth Report providing a summary and analysis of offers received for the Fund-related Assets by noon on January 26, 2007. However, immediately prior to releasing the report, the Monitor was contacted by HCP and the Fund, acting jointly, requesting a delay of two hours to allow time for the submission of a revised offer. The Monitor advised me of the receipt of such revised offer when it delivered the Nineteenth Report to me on January 26, 2007 and provided a copy of the newly-revised offer (the "Harbinger Final Offer"). The Monitor indicated that it would be canvassing major stakeholders to receive their input on the offers and would issue a supplemental report to the Nineteenth Report prior to the court hearing on January 30, 2007. On Monday, January 29, 2007, I asked the Monitor to include in such report an analysis of the Harbinger Final Offer and any other offers it might receive prior to the release of this supplemental report.

39 The Monitor issued its Twentieth Report late in the day on January 29, 2007. In addition to the Harbinger Final Offer, the Monitor had received a letter from Catalyst Capital Group Inc. ("Catalyst") varying certain of the terms of an offer it had submitted by Friday's deadline in view of the press release issued by HCP relating to the Harbinger Final Offer. These revised terms were incorporated into the Monitor's analysis of the Catalyst offer.

40 Four offers were presented to the Court on Tuesday, January 30, 2007. One was a revised offer from the Fund. One was a revised offer from HCP received by the Monitor on January 26, 2007 (the "Second Revised HCP Offer"). One was an offer from Catalyst as revised on January 29, 2007 (the "Revised Catalyst Offer"). One was the Harbinger Final Offer. The Monitor recommended the Harbinger Final Offer.

41 The Harbinger Final Offer provides certainty of price and certainty of closing. It eliminates risks associated with the splitting and realization of certain claims CLP has made against the Calpine Applicants, and it facilitates the capture of value for creditors with respect to the Whitby cogeneration project by allowing the prepayment of a loan related to the project and the sale by CCPL of its interest in the project. It has no material conditions, and eliminates the uncertainty of future litigation with the Fund as the Fund has undertaken to support the offer and to provide the necessary consents.

42 This certainty, of course, comes with a price, which is that between approximately $10 million and $34 million of additional potential consideration would be forgone compared to the Second Revised HCP Offer, the Revised Catalyst Offer or a new Catalyst offer briefly described by counsel during the hearing (the "New Catalyst Offer").

43 As the Monitor points out, there is substantial closing risk associated with the Second Revised HCP Offer and the Revised Catalyst Offer, risks that likely would erode the potential financial upside of those offers. The Second Revised HCP Offer, which carries the least risk, could not guarantee the consent of the Fund to either the transfer of the MA&O Agreements and the B Units or the outcome of an application to hold in abeyance the Fund's application to terminate the MA&O Agreements for a reasonable time following closing. Nor could it guarantee the outcome of an application for a permanent stay of any claim by the Trust or the Fund to terminate the MA&O Agreements for default due to the CCAA proceedings. These are risks not only of outcome but of time, as litigation would be required not only in this Court, but also might be prolonged by appeal.

44 The Revised Catalyst Offer and the New Catalyst Offer carry the same risks and more. Although the Fund may be constrained in rationalizing a refusal of consent with respect to the Second Revised HCP Offer by reason of its support of the Harbinger Final Offer, it would not be so constrained in refusing consent with respect to Catalyst. The Revised Catalyst Offer (and presumably the New Catalyst Offer, although this was not made clear) were subject to due diligence, regulatory approval, and, with respect to its higher range of value, the ability of Catalyst to come to an agreement with CCPL and perhaps the Fund to achieve value from the Whitby project. Originally, the Revised Catalyst Offer could be terminated at any time before acceptance. While Catalyst, in its submissions

during the hearing, stated that it was prepared to abandon this condition, it was not clear how long it was prepared to leave its offers open.

45 The Ad Hoc ULC I Noteholders Committee expressed the wish to continue the process to see if greater value could be achieved. While the temptation to continue the process is understandable, given the carrot of higher offers and the suggestion of late-breaking developments in the take-over bid for the Fund's public trust units, prolonging the process would not allow Catalyst or any other new bidder the opportunity to overcome the serious contract transfer and contract termination risks that shadow their offers, given that the Fund is now bound to support the Harbinger Final Offer. Only the Harbinger Final Offer can provide the assurance that prolonged litigation with the Fund will be avoided, at least in the time frame imposed on this process by the take-over bid.

46 In addition, given my decision on January 22, 2007 to allow an abbreviated process, and not the more leisurely time-frame requested by some of the bidders, it would be unfair to extend the process on the basis of Catalyst's last-minute, in-Court efforts to improve its bid.

47 I also considered the objection raised by the Ad Hoc ULC I Noteholders Committee to the transfer of value to the public unitholders arising from the Harbinger Final Offer. It is true that value that potentially existed under the Second Revised HCP Offer has been transferred from the Calpine creditors to the public unitholders of the Fund under the Harbinger Final Offer through the sweetening of the HCP take-over bid, but this did not occur without the significant advantage of greater certainty. It is noteworthy that the Monitor in his Seventeenth Report was prepared to recommend the Settlement Agreement with its lower consideration over the Harbinger Offer on the basis of that uncertainty.

48 The process was certainly not pretty. It started with a privately-negotiated Settlement Agreement that could not be disclosed in a way that would create a level playing field for all interested parties. There were good-faith reasons for the negotiation of such an agreement, set out in the affidavits and cross-examinations of the Calpine Applicants and the Fund, reasons rooted in attempting to achieve a balance between the Calpine Applicants' goal of value maximization and the Fund's need for confidentiality arising from both commercial proprietary interest and the threat of the take-over bid. Nevertheless, as I indicated earlier, the restrictions on disclosure arising from these circumstances could not be sanctioned in the context of a public CCAA proceeding with many stakeholders.

49 The Fund-related Assets are, as many parties noted, unique and unusual assets. They are part of a web of intertwined relationships in a complex corporate structure. As the Calpine Applicants recognized, the value of these assets could be optimized because of the take-over bid and the strategic challenges facing Harbinger and the Fund relating to that take-over bid. While advantageous to the Calpine creditors in that respect, the situation foreclosed a more traditional court-supervised auction that may have been appropriate for a different kind of

asset and created a brief window of time for maximizing value. Perfection of process was highly unrealistic in these circumstances.

50 Has value been maximized under the abbreviated sales process? As some of the case law on process notes, a good test of whether a process has produced improvident bids is whether a substantially higher bid surfaces at the approval stage. In this case, while the last-minute bid by Catalyst was higher, it was not substantially so, and the improvements offered at the last minute by Catalyst to eliminate conditions in its bid were not so attractive as to lead to the concern that unrealized value lurked in the market if only the process had been extended.

51 There was criticism of the Harbinger Final Offer on the basis that it came in after the deadline for final offers had expired. However, Catalyst was afforded the same opportunity to revise its previous offer. In fact, it did so, and its revised offer was considered by the Monitor. This was not a formal tender process with an elaborate set of terms and conditions. Given the short time line forced by external circumstances, a certain amount of flexibility was necessary and was afforded to both HCP and Catalyst, but the integrity of the process required that that flexibility end at the time of hearing on January 30, 2007. The ability afforded to both HCP and Catalyst to revise their bids prior to the completion of the Monitor's Twentieth Report was not unfair, nor did it materially compromise the process.

52 It must be emphasized that the Monitor recommended that the HCP Final Offer be accepted and set out thorough and thoughtful reasons for that recommendation in its Twentieth Report. That recommendation was unshaken by Catalyst's last-minute attempts to improve its bid. While this application involves a Monitor under the CCAA, rather than a court-appointed receiver, I endorse the view of the Anderson, J. in *Crown Trust Co. v. Rosenberg* (1986), 60 O.R. (2d) 87, 67 C.B.R. (N.S.) 320 (note), 22 C.P.C. (2d) 131, 39 D.L.R. (4th) 526 (Ont. H.C.) set out at page 112:

> If the court were to reject the recommendations of the Receiver in any but the most exceptional circumstances, it would materially diminish and weaken the role and function of the Receiver both in the perception of receivers and in the perception of any others who might have occasion to deal with them. It would lead to the conclusion that the decision of the Receiver was of little weight and that the real decision was always made upon the motion for approval. That would be a consequence susceptible of immensely damaging results to the disposition of assets by court-appointed receivers.

53 The Monitor in this case has been intimately involved in the proposed sale of the Fund-related Assets from the beginning and for more than a year has accumulated valuable knowledge and insight into the complications and intricacies of the very complex corporate structure of the Calpine Applicants. The opinion of the Monitor deserves respect and deference. If, as the Court in *Soundair* commented at para. 14, "(t)he best method of selling an airline at the best price is something far removed from the expertise of a court", so is navigating the diffi-

cult shoals of selling unique, illiquid assets forming part of a complex corporate network with bidders preoccupied with broader external challenges. The recommendation of the Monitor, who was faced with a number of difficult variables and a rapidly-changing set of circumstances, was sound and reasonable.

54 I therefore found that the Harbinger Final Offer should be approved, as it provided for a reasonable balance of price and closing certainty, was endorsed by many of the stakeholders and was recommended by the Monitor.

55 Given the unique nature of the assets being sold, the nature of the closing risks, and in particular the nature of the material conditions affecting the value of the Revised Catalyst Offer, I agree with the Monitor, the Calpine Applicants, the independent trustees, the ULC II Bondholder groups and the U.S. Calpine entities that the potential for increased consideration through a continuation of the process or acceptance of the more conditional offers is outweighed by the risks and potential delay that would follow.

Application granted.

TAB "19"

Disposition

20 In the result, the appeal is dismissed. Costs are awarded to the respondent and are fixed in the amount of $8,000, inclusive of G.S.T. and disbursements.

Appeal dismissed.

[Indexed as: **AIT Advanced Information Technologies Corp., Re**]

In the Matter of the Securities Act, R.S.O. 1990, c. S.5, as Amended

In the Matter of AiT Advanced Information Technologies Corporation, Bernard Jude Ashe and Deborah Weinstein

Ontario Securities Commission

W.S. Wigle Chair, H.P. Hands, C.S. Perry Commrs.

Heard: September 5-7, 10-11, 17, 19-21, 26-27, 2007; October 16, 2007

Judgment: January 14, 2008

Docket: None given.

Jane Waechter, Stephanie Collins, Erez Blumberger, Scott Pilkey for Ontario Human Rights Commission

Alistair Crawley, Matthew Scott for Deborah Weinstein

Wendy Berman — Independent Counsel for Deborah Weinstein in attendance on September 5, 2007

John Fabello for Bernard Jude Ashe, in attendance on September 5, 6 and 7, 2007

Securities — Trading in securities — Definitions — Material change — Corporation was technology company traded on stock exchange — Corporation began merger negotiations, which resulted in letter of intent being signed, subject to due diligence and other factors — Rumour began that corporation was to be taken over, and value of shares rose — Negotiations were ultimately successful — Director of securities commission claimed that corporation did not disclose merger on timely basis — Hearing was held to determine if s. 75 and s. 122(3) of Securities Act were breached — No breach of Act occurred, corporation did not fail to disclose material change — Standard of proof was balance of probabilities on clear and cogent evidence — No bad faith existed or was alleged — Negotiations were material, but did not result in material change during period at issue — Whether material change has occurred is not bright line test — Whether negotiations constitute material change is to be measured on case by case basis, taking into account degree of certainty transaction will occur — During relevant period, insufficient likelihood that transaction would be completed and uncertainty existed regarding buyer's commitment — Entering into non-binding letter of agreement was not material change and did not alter business, operations or capital — No significant events occurred be-

tween letter of agreement and increase in share price due to rumour which warranted material change — Materiality more likely to occur at earlier stage for smaller company than large company — Retaining advisors does not constitute material change.

Cases considered:

AiT Advanced Information Technologies Corp., Re (2007), 30 O.S.C.B. 4694 (Ont. Securities Comm.) — referred to

Basic Inc. v. Levinson (1988), 485 U.S. 224, 99 L.Ed.2d 194, 56 U.S.L.W. 4232, 108 S.Ct. 978 (U.S. Ohio) — referred to

Bennett, Re (1996), [1996] 34 B.C.S.C.W.S. 55 (B.C. Securities Comm.) — considered

Burnett, Re (1983), 6 O.S.C.B. 2751 (Ont. Securities Comm.) — considered

Doman v. British Columbia (Superintendent of Brokers) (1998), 113 B.C.A.C. 91, 184 W.A.C. 91, 9 Admin. L.R. (3d) 200, 1998 CarswellBC 2207, 59 B.C.L.R. (3d) 217, [1998] B.C.J. No. 2378 (B.C. C.A.) — referred to

Doman v. British Columbia (Superintendent of Brokers) (1999), 243 N.R. 198 (note), (sub nom. *Doman v. Superintendent of Brokers (B.C.)*) 133 B.C.A.C. 65 (note), (sub nom. *Doman v. Superintendent of Brokers (B.C.)*) 217 W.A.C. 65 (note), [1998] S.C.C.A. No. 601 (S.C.C.) — referred to

Kerr v. Danier Leather Inc. (2005), 205 O.A.C. 313, 2005 CarswellOnt 7296, 261 D.L.R. (4th) 400, 11 B.L.R. (4th) 1, 77 O.R. (3d) 321, [2005] O.J. No. 5388 (Ont. C.A.) — considered

Kerr v. Danier Leather Inc. (2007), 2007 SCC 44, 2007 CarswellOnt 6445, 2007 CarswellOnt 6446, 87 O.R. (3d) 398 (note), 36 B.L.R. (4th) 95, [2007] S.C.J. No. 44 (S.C.C.) — considered

Lett, Re (2004), 2004 CarswellOnt 1130, 27 O.S.C.B. 3215 (Ont. Securities Comm.) — considered

Philip Services Corp., Re (2006), 2006 CarswellOnt 2818, 29 O.S.C.B. 3941 (Ont. Securities Comm.) — considered

Securities & Exchange Commission v. Texas Gulf Sulphur Co. (1968), 401 F.2d 833 (U.S. 2nd Cir. N.Y.) — referred to

Securities & Exchange Commission v. Texas Gulf Sulphur Co. (1971), 446 F.2d 1301 (U.S. C.A. 2nd Cir.) — referred to

Siddiqi, Re (2005), 25 B.L.R. (4th) 125, 2005 CarswellBC 3590, 2005 BCSECCOM 416, [2005] B.C.S.C.D. No. 542 (B.C. Securities Comm.) — considered

TSC Industries Inc. v. Northway Inc. (1976), 96 S.Ct. 2126, 48 L.Ed.2d 757, 426 U.S. 438, Fed. Sec. L. Rep. 95,615 (U.S. Ill.) — referred to

Wilder v. Ontario (Securities Commission) (2001), 24 O.S.C.B. 1953, 142 O.A.C. 300, 53 O.R. (3d) 519, 2001 CarswellOnt 823, 197 D.L.R. (4th) 193, [2001] O.J. No. 1017 (Ont. C.A.) — considered

YBM Magnex International Inc., Re (2003), 2003 CarswellOnt 2632, 26 O.S.C.B. 5285 (Ont. Securities Comm.) — considered

Statutes considered:

Securities Act, R.S.O. 1990, c. S.5

Generally — referred to

s. 1(1) "material change" — considered

s. 1(1) "material fact" — considered

s. 1.1 [en. 1994, c. 33, s. 2] — considered

s. 75 — considered
s. 75(3) — considered
s. 76 — referred to
s. 122 — considered
s. 122(1)(c) — considered
s. 122(3) — considered
s. 127 — considered
s. 127(1) — referred to

Words and phrases considered

material change

Not all material facts will be significant enough to constitute a change in the business, operations or capital of the issuer, and therefore be a material change. The [Securities Act, R.S.O. 1990, c. S.5] makes an important distinction between the definitions of a material fact and a material change in subsection 1(1). This distinction is fundamental to the various requirements under the Act since certain disclosure requirements are triggered by the occurrence of a material change (but not a material fact). For example, only in the event of a material change does section 75 of the Act require an issuer to issue a news release and also file with the Commission a material change report on a timely basis, or alternatively file a confidential material change report with the Commission. In contrast, section 76 of the Act does not require disclosure of either material changes or material facts, but prohibits anyone from purchasing or selling securities with knowledge of a material fact or material change that has not been generally disclosed to the public.

As Anisman explains in his expert report, the distinction between "material facts" and "material changes" in the legislation recognizes the need of issuers to keep certain developing transactions confidential in the course of negotiations. For example, in a negotiation for a merger transaction, such negotiations may be material at a very early stage and for the purpose of insider trading laws, persons aware of such "material facts" should be prohibited from trading on this information. However, this may be well before the negotiations have reached a point of commitment to be characterized as a change in the issuer's business, operations or capital, and therefore, before public disclosure of the information would be appropriate

HEARING pursuant to *Securities Act*, regarding disclosure of material change.

***Per curiam*:**

I. Overview

A. Introduction

1 This was a hearing before the Ontario Securities Commission (the "Commission") to decide whether Deborah Weinstein ("Weinstein") authorized, permitted or acquiesced in a breach of the *Securities Act*, R.S.O. 1990, c. S.5, as amended (the "Act") and acted contrary to the public interest by authorizing, permitting or acquiescing in Advanced Information Technologies Corporation's ("AiT") failure to disclose forthwith the merger transaction between AiT and 3M Company ("3M") as a material change by April 25, 2002 and in any event

not later than May 9, 2002 ("the Relevant Period"). The parties agreed that this proceeding should be bifurcated; first a hearing on the merits; and second, if necessary, a hearing to address sanctions.

2 This proceeding was commenced by a Statement of Allegations (the "Allegations") and notice of hearing (the "Notice of Hearing"), dated February 8, 2007.

3 It is alleged that AiT contravened section 75 of the Act and engaged in conduct contrary to the public interest by failing to disclose forthwith the merger transaction (the "Merger Transaction"), between AiT and 3M, as a material change; and that, Weinstein and Bernard Jude Ashe ("Ashe") committed an offence pursuant to section 122(3) of the Act and engaged in conduct contrary to the public interest by authorizing, permitting or acquiescing in AiT's failure to disclose forthwith the Merger Transaction as a material change. These are the issues which we must consider.

4 It is important to note that this is not a case where bad faith is alleged. Staff of the Commission ("Staff") clarified in the opening statement that it is not alleged that Weinstein intended to violate securities law or actively mislead the market, nor is there any suggestion of impropriety or bad faith on the part of the AiT Board of Directors (the "AiT Board") in making its decision not to disclose the 3M negotiations during the Relevant Period.

5 On September 5, 2007, the hearing on the merits commenced and evidence was heard on September 5, 6, 7, 10, 11, 17, 19, 20, and 21, 2007. Following the close of evidence, we heard submissions on the merits on September 26, and 27, and October 16, 2007.

B. Summary of our Decision

6 Upon reviewing all the evidence and the applicable law, we have concluded that there is no clear and cogent evidence that a material change occurred during the Relevant Period. Specifically:

(1) We agree with the submissions of Staff that, in appropriate circumstances, a material change can occur in advance of the execution of a definitive binding agreement, and therefore, the determination of whether a material change has occurred is not a "bright-line" test. Instead, the assessment of whether a material change has occurred, particularly in the context of an arm's length negotiated transaction, will depend on the specific facts and circumstances of each case and will vary case to case;

(2) In considering whether a board resolution constitutes a "decision to implement such a [material] change" within the definition of material change in the Act, in the context of an arm's length negotiation of a merger transaction before a definitive agreement has been reached, there must be sufficient evidence by which the board could have concluded

that there was a sufficient commitment from the parties to proceed and a substantial likelihood that the transaction would be completed;

(3) With specific reference to the AiT Board resolution of April 25, 2002, we conclude that there was insufficient evidence available at that time to determine that: (i) 3M was committed to proceed with a transaction; and (ii) there was a substantial likelihood that the transaction being discussed would be completed.

(4) In assessing the letter of intent ("LOI") entered into between AiT and 3M on April 26, 2002, we conclude from a detailed analysis of all the facts and circumstances in this case that entering into the LOI did not constitute a material change in the business, operations or capital of AiT;

(5) During the portion of the Relevant Period after the signing of the LOI, no developments occurred in the status of the negotiations which would have led AiT to conclude that 3M was then more committed to proceed or that there was at that time a substantial likelihood that the transaction would be completed;

(6) Having concluded that there was no material change in the business, operations or capital of AiT during the Relevant Period, AiT did not breach section 75 of the Act and was not required to make timely disclosure of its negotiations with 3M. Since the allegations against Weinstein were that she had breached sections 122(3) and 127(1) of the Act which were premised upon a breach by AiT of section 75, those allegations against her must be dismissed.

II. Background

A. The Respondent: Weinstein

7 AiT was a federally incorporated company located in Ottawa. It was a reporting issuer in Ontario, and its shares traded on the Toronto Stock Exchange ("TSX").

8 Weinstein is a partner in the law firm LaBarge Weinstein LLP in Ottawa, and practices in the areas of securities and corporate finance. Weinstein's clients include both public and private companies. Since the spring of 1993, AiT was one of Weinstein's clients.

9 Weinstein became a director of AiT in 1996, and during the Relevant Period, was one of eight directors of AiT.

B. History of Proceedings

1. The Statement of Allegations

10 The Allegations alleged that the Merger Transaction constituted a material change within the meaning of section 75 of the Act by April 25, 2002, and in any event, not later than May 9, 2002.

11 The Allegations were issued in relation to three respondents: (1) AiT; (2) Ashe; and (3) Weinstein (collectively the "Respondents"). The allegations are as follows:

(1) AiT contravened section 75 of the Act and engaged in conduct contrary to the public interest by failing to disclose forthwith the Merger Transaction as a material change; and

(2) Weinstein and Ashe committed an offence pursuant to subsection 122(3) of the Act and engaged in conduct contrary to the public interest by authorizing, permitting or acquiescing in AiT's failure to disclose forthwith the Merger Transaction as a material change.

2. The Settlement Agreements

12 On February 19, 2007, AiT entered into a Settlement Agreement, and on February 23, 2007, Ashe entered into a Settlement Agreement. Both Settlement Agreements were approved on February 26, 2007.

3. Preliminary Motions

13 Before the hearing on the merits, a number of preliminary motions were dealt with. On May 9, 2007, a Panel heard Weinstein's motion to dismiss the proceeding (the "Motion to Dismiss"). It was ordered that "the Motion to Dismiss be adjourned until Staff has called its evidence at the hearing, subject to the discretion of [Weinstein] and subject to the discretion of the panel at the hearing" ((2007), 30 O.S.C.B. 4694 (Ont. Securities Comm.)).

14 On June 13, 2007, Staff brought a motion to determine whether Alistair Crawley ("Crawley") and Crawley Meredith LLP should be removed as counsel of record for Weinstein due to a conflict of interest (the "Motion for Removal of Counsel"). In Staff's view, there was a conflict of interest because Staff might call witnesses at the hearing on the merits to testify against Weinstein who are Crawley's former clients, and Crawley would be put in the position of cross-examining them. The Panel determined that Crawley could continue to act for Weinstein, subject to conditions, which included having Weinstein retain independent counsel to cross-examine any witnesses that were former clients of Crawley.

15 Staff also brought a motion returnable on August 24, 2007 to ask for directions regarding the order issued regarding the Motion for Removal of Counsel because one of Staff's witnesses, Paul Damp ("Damp"), gave his consent to be

cross-examined by Crawley instead of Weinstein's independent counsel. Prior to the hearing of this motion, Staff and Weinstein's counsel resolved the motion by agreeing that Weinstein would irrevocably undertake to call Damp as a witness in defence, so that Crawley would be able to lead Damp's evidence by way of direct examination. This would eliminate the need for Crawley to cross-examine Damp, his former client. Weinstein acknowledged that the Motion to Dismiss may only be brought after Damp's testimony. During the hearing on the merits, counsel for Weinstein did not raise the issue of the Motion to Dismiss after Damp's testimony.

III. The Issues

16 Staff's allegations involve section 75 and subsection 122(3) of the Act, and the allegations raise two primary issues:

(1) did the status of the negotiations with 3M constitute a "material change" in the business, operations or capital of AiT during the Relevant Period as alleged by Staff, in which case AiT would have been required by section 75 of the Act to: issue a news release forthwith providing notice of the material change and file a material change report, or in the alternative, file a confidential material change report with the Commission; and

(2) if so, did Weinstein in her capacity as a director of AiT, authorize, acquiesce or permit a breach by AiT of section 75 in contravention of subsection 122(3) of the Act and contrary to the public interest under subsection 127(1) of the Act.

IV. The Evidence

A. Chronology of Events

17 Staff and Counsel for Weinstein provided a joint hearing brief comprised of nine binders containing evidence relating to the chronology of events involving the Merger Transaction. Staff informed us at the outset of the hearing that the documents contained in the joint hearing brief were tendered on consent of the parties, unless otherwise specified at the hearing.

18 The following is our summary of the chronology of events relating to the Merger Transaction based on the uncontested evidence adduced by the parties.

1. Description of AiT's Business

19 In September of 2001, AiT had approximately 110 employees and annual revenue in the range of $16-17 million.

20 At this time, Ashe was the President, Chief Executive Officer ("CEO") and a director of AiT.

21 AiT's principal business was the sale of systems to issue and inspect secure travel documents, including passports (a.k.a. the ID business). AiT was a market

leader in the ID business, with its largest customer being the Canadian government.

22 AiT had also started a business unit called Affinitex, which was aimed at providing security identity solutions to the U.S. health care industry. At the time of the events surrounding the Merger Transaction, Affinitex was a new venture in development and had no customers.

2. *AiT's Condition in 2001 to 2002*

23 For its fiscal year ending on September 30, 2001, AiT had a negative cash flow from operations of $2 million and had a net loss of over $3.6 million. The negative cash flow and net loss were primarily due to the investment in Affinitex.

24 As at September 30, 2001 AiT had credit facilities totaling $4.5 million with CIBC, of which approximately $2.8 million was drawn. The total amount of $4.5 million comprised an operating facility of $3.5 million (that was secured by receivables, inventory and other assets), and a term facility in the amount of $1.0 million that was set up at the time that equity was raised for the investment in Affinitex. The term facility had a maturity date of March 31, 2002.

25 On September 11, 2001, the AiT Board held a meeting, and the focus of this meeting was to agree on some spending cuts and employee terminations in both Affinitex and the core ID business. This was necessary at this time because AiT had not yet secured any customers for Affinitex.

26 In response to the terrorist attacks of September 11, 2001, AiT decided to meet with customers and determine first hand what the priorities of customers (i.e. governments) would be post-September 11, 2001, and how AiT's business could respond. The outcome from meeting with customers revealed to AiT that AiT had to get bigger in order to be able to bid on some of the opportunities that would be coming up in the future. This meant that AiT would have to partner with or be acquired by a larger company.

27 On October 26, 2001, AiT's Strategic Committee, which was a standing committee of the AiT Board composed of Ashe, Damp, Richard Lesher ("Lesher"), Graham Macmillan ("Macmillan") and Stephen Sandler ("Sandler") (the "Strategic Committee"), met to discuss opportunities for AiT and Affinitex. Ashe provided a memo to the Strategic Committee, which recommended that AiT focus on the traditional company business, the ID business, as a way to grow the company. This memo also alerted the Strategic Committee that AiT's cash position was very "tight" and that AiT needed to strengthen its financial position. At this time, the bank's position was that they wanted AiT to stop investing ID business profits into Affinitex product development.

3. The Proposed Equity Financing Transaction

28 At the Strategic Committee meeting of October 26, 2001, Ashe recommended that AiT should raise equity and engage the investment dealer Raymond James as its agent for this purpose. Raymond James was an investment banker specializing in biometrics and security-related investments and deals. The recommendation was to raise between $3 million and $5 million by way of a private placement and on a best-efforts basis.

29 AiT's shares were thinly traded, and AiT's directors and senior officers held approximately 30% of the outstanding shares. As well, no equity research analysts were covering AiT.

30 The purpose of raising equity was to allow AiT to look at alternatives including further product development and possible partnering with larger companies. Ashe also recommended selling AiT. According to Ashe, raising equity would buy AiT time to consider its alternatives.

31 On the recommendation of the Strategic Committee, the AiT Board approved the equity financing plan and the engagement of Raymond James at the AiT Board meeting on November 12, 2001.

32 However, the efforts to raise equity financing were unsuccessful. Institutional investors had concerns about investing in AiT relating to AiT's history and relatively small market capitalization. AiT received only moderate interest and approximately $2 million of confirmed investment orders, and in December 2001 the equity financing was withdrawn.

4. The Proposal to Engage an M&A Advisor.

33 After the proposed equity financing failed, Ashe's opinion was that AiT was at a point where it needed to move to sell the company. In late January, he discussed with the Executive Committee the idea of finding an acquirer for AiT. There was general agreement that this was the right thing to do.

34 Ashe also felt that AiT needed to engage an M&A advisor to assist with the process to sell AiT, to give advice on potential acquirors and how to position AiT for the best possible outcome. On January 25, 2002, Ashe discussed the idea of hiring an M&A advisor with the Strategic Committee and it agreed that the issue of hiring an M&A advisor should be brought for approval by the AiT Board at its meeting in February 2002.

35 On February 19, 2002, the AiT Board unanimously agreed to engage an advisor to investigate strategic opportunities for AiT and delegated the responsibility for selecting the advisor to the Strategic Committee.

5. The Unsolicited Approach of 3M

i. Harrold's Telephone Call in February 2002

36 Steve Harrold ("Harrold") was the manager of the Security Market Center at 3M headquarters in St. Paul, Minnesota.

37 Prior to Harrold contacting Ashe, AiT had previously had some interaction with 3M. In late October 2001, a technical team from 3M came to visit AiT to get an update on AiT's products and technology. This meeting was organized after Ashe was contacted by email on October 15, 2002, by Andy Dubner of 3M to discuss exploring a new business opportunity. After this meeting, there was a continuing discussion between the technical people at 3M and AiT to keep each other informed on technical developments and other matters.

38 By letter dated December 11, 2001, Harrold contacted Ashe to follow up on the discussions that took place in October 2001. A non-disclosure agreement was enclosed with this letter. In addition, Harrold followed up with an email to Ashe dated December 27, 2001 to set up a meeting to discuss business and technical issues and strategic partnership opportunities between 3M and AiT.

39 Subsequent to this correspondence, Ashe signed the non-disclosure agreement on January 15, 2002. Ashe's meeting with Harrold in late January was cancelled.

40 The next contact Ashe had with Harrold was by telephone around February 17 and 18, 2002, which was the same time when Ashe was meeting with M&A advisor candidates. In this telephone call, Harrold disclosed that 3M was looking for acquisitions, ways to grow its business, and was interested in looking at AiT.

41 After this phone call from Harrold, Ashe focused on this opportunity with 3M and gave it priority.

ii. The February 28, 2002 Meeting with Harrold

42 Ashe met with Harrold on February 28, 2002 in Ottawa to discuss opportunities for AiT and 3M. Harrold informed Ashe that 3M was looking for companies to acquire that fit their strategy, and that 3M was interested in AiT because 3M did not have any software and systems development capabilities and 3M wanted to have a stronger position in the document reader market.

43 Harrold also informed Ashe that he was a manager for the Security Markets Centre for 3M, and that he reported to Pete Swain, the Vice-President of the Safety and Security Systems Division ("Swain"), who reported to Ron Weber the Executive Vice President, Transportation, Graphics & Safety Markets ("Weber"). Weber reported to the CEO, Jim McNerney ("McNerney").

44 At this meeting, Harrold also informed Ashe that 3M used a process called Six Sigma ("Six Sigma") to make business decisions. It was understood that Six Sigma was a highly structured process that improved important decision-making by attempting to remove intuition and judgment and relying on extensive mea-

surements of data and facts. For example, adhering to this process was believed to reduce costs, improve revenue and improve process throughputs. Ashe testified that Six Sigma required very deliberate steps to be taken, and included a blue book process (the "Blue Book Process") that was to be followed in the second phase of due diligence.

45 At the end of the meeting, Harrold informed Ashe that he would get back to Ashe regarding the issue of timelines.

46 After the discussion with Harrold, AiT deferred its process to hire an M&A advisor.

iii. The March 4, 2002 Phone Call

47 On March 4, 2002, Harrold called Ashe to confirm the timetable that 3M would use to conduct their due diligence and to follow the process that they had to follow in order to make a decision on the proposed purchase of AiT.

48 The timetable included two phases of due diligence: first an overall high level version of due diligence, and second, the Blue Book Process that 3M adhered to. The latter was a much more detailed level of due diligence and required certain approvals by the 3M board and executive. It was an extensive process that involved looking at all the different dimensions of an investment decision, including cash and financing considerations, and issues relating to human resources, research and development, technology, intellectual property and taxation.

49 According to the timetable, the first due diligence visit of AiT would be conducted by 3M on March 26, 27 and 28, 2002 and discussion regarding pricing and valuation of AiT would occur on April 10 to 12, 2002. Ashe agreed to this timetable and found that it was reasonable.

50 Following the timetable discussions on March 4, 2002, AiT and 3M entered into a non-disclosure agreement specifically relating to such a potential transaction on March 12, 2002. The non-disclosure agreement included customary provisions prohibiting 3M from acquiring, or offering to acquire, shares of AiT without the consent of the AiT Board.

6. The First Due Diligence Visit: March 26, 27 and 28, 2002

51 On March 14, 2002, Ashe received a copy of 3M's due diligence checklist by email, and AiT prepared the appropriate documentation and presentations for the scheduled due diligence review.

52 On March 26, 27 and 28, 2002, the first due diligence visit took place at the offices of AiT and LaBarge Weinstein. Management presentations and product demonstrations took place at AiT's offices, while documentation, contract and financial reviews took place at the offices of LaBarge Weinstein.

53 Swain, Harrold, and, approximately 8-10 other managers and directors in the business development, technical and financial areas of 3M's various divisions attended the due diligence review.

54 AiT perceived their product demonstrations to have gone well. Overall, AiT felt that the due diligence was successful and received positive feedback from 3M about the visit. Based on the feedback received, Ashe believed 3M to be very serious about pursuing a transaction with AiT. AiT was also very serious and perceived the discussions to be progressing very well.

7. The Creation of the Valuation Committee: April 8, 2002

55 After the due diligence visit, AiT felt confident that the discussions would proceed to pricing, which was going to be an important step in the process. Ashe was concerned about 3M's valuation of AiT, and created a Valuation Committee with Weinstein and Damp to prepare for upcoming pricing discussions with 3M.

56 The Valuation Committee conducted research on how 3M approached valuation on previous deals and how they could present their own valuation of AiT. They prepared valuations of AiT based on various scenarios and assumptions, and prepared materials outlining its strengths and weaknesses for the pricing negotiations. The Valuation Committee also ensured they were on the same page regarding their understanding of the business issues facing AiT at that time.

8. The Meeting in St. Paul: April 11 and 12, 2002

57 On April 11 and 12, 2002, a meeting regarding AiT's valuation was held at 3M's offices in St. Paul, Minnesota. Ashe, Damp and Weinstein attended the meeting on behalf of AiT. On 3M's side, the meeting was attended by Harrold, Walt Scheela who directly reported to Weber ("Scheela"), and Kevin Curran who was a marketing manager directly reporting to Harrold.

58 On April 11, 2002, both AiT and 3M refused to put the first number on the table. AiT used this opportunity to gauge 3M's perceptions of AiT and the strengths and weaknesses in its business. At the end of the meeting, it was agreed that AiT would return with a number the next morning.

59 Damp used the information they extracted from the meeting regarding 3M's valuation criteria to prepare a forecast and develop a proposed valuation for AiT in the amount of $75 million. On April 12, 2002, AiT revealed their number to 3M. 3M objected to AiT's valuation of $75 million. This led to a discussion over a few hours regarding numbers, statistics and objections.

60 By the end of the discussion, AiT and 3M agreed to disagree, and AiT left with the understanding that 3M valued AiT between $35 and $45 million. There was also some discussion that the proposed transaction would be structured as an asset purchase because 3M did not see value in Affinitex or AiT's tax loss carry-forwards.

61 At this point Ashe consulted with Weinstein whether disclosure had to be made of the events that were unfolding with 3M, and Weinstein informed Ashe that there was no obligation to disclose at this stage of the negotiations because "nothing had happened".

9. Harrold's Telephone Calls Regarding the Value of AiT

i. The Telephone Call of April 23, 2002

62 On April 23, 2002, Harrold, Scheela and Sarah Grauze telephoned Ashe and held a conference call to discuss 3M's view of AiT's value. During this conference call, it was revealed that 3M felt AiT's value should be pegged at $40 million. Ashe made it clear that he had no authority to agree or disagree with this number and that he would have to take it to the AiT Board. During this phone call, Ashe was not successful in making any progress to improve 3M's number of $40 million.

ii. The Telephone Call of April 24, 2002

63 On April 24, 2002, there was another telephone conference call regarding AiT's value. Harrold, Scheela and Ashe participated in this call. During this call, Ashe asked for approximately $3 million dollars to be added to 3M's number of $40 million. After further discussions, 3M added $1 million on their original price, for a total of $41 million. It was also established during this call that the $41 million was for the whole company, including Affinitex. The proposed transaction was to be structured as a share purchase with $41 million representing a price of $2.88 per share of AiT.

64 Through further discussions, AiT also resolved the issue of the treatment of "in-the-money" stock options, and 3M agreed to pay a total of $42.6 million for the company, which included stock options.

65 According to Ashe this was the end of the pricing discussions with 3M, and the next step was to inform the AiT Board.

10. The AiT Board Meeting: April 25, 2002

i. The AiT Board's Approval

66 The AiT Board meeting on April 25, 2002, was held by telephone conference call. The minutes state that all of the directors of AiT (Ashe, Allan Churgin, Damp, Lesher, Edward C. Lumley ("Lumley"), Macmillan, Sandler and Weinstein) were present.

67 During the meeting, Ashe updated the AiT Board regarding the phone calls and meeting with 3M since the beginning of April, including the meeting in St. Paul on April 11 and 12, 2002, and the phone calls on April 23 and 24, 2002. The purpose of this meeting was to obtain the AiT Board's support for the pro-

posed valuation of AiT, in order to enable 3M to proceed with the next step in the negotiations, the preparation of a non-binding LOI.

68 During the AiT Board meeting of April 25, 2002, the issue of disclosure of the 3M proposal was discussed. This issue was raised by Lumley, and the discussion on disclosure lasted approximately 20 minutes. Further evidence regarding the discussion on disclosure is addressed in the section of our Reasons dealing with the testimony of the witnesses and the affidavits.

69 The Minutes of the AiT Board meeting on April 25, 2002, summarize Ashe's update to the AiT Board:

> As a result of further discussions 3M came back with a verbal offer of $2.88 per share payable in cash on closing by 3M for all the outstanding shares and options of the company. After taking into account the exercise price of outstanding options this resulted in an aggregate purchase price of approximately Cdn $41 million. Subject to Board approval by AiT, 3M would draft for execution by both parties a non-binding letter of intent to acquire all the shares as discussed. The parties have agreed to work diligently towards a definitive agreement and announcement.

70 Following Ashe's update, the minutes of the AiT Board meeting record that the AiT Board unanimously "approved the recommendation to shareholders of the acquisition by 3M of all of the outstanding shares and options in [AiT] at a cash purchase price of $2.88 per share [...]."

71 In addition, the Minutes of April 25, 2002 state that this approval was subject to:

> [...] confirmation of the fairness of this price by AiT's financial advisor, CIBC Investment Banking, and satisfaction of the Board with the final terms of the transaction, including the tax consequences to the Company's shareholders.

72 The AiT Board also authorized Ashe to execute any documents in furtherance of the transaction with 3M, including the non-binding LOI.

ii. The Email to the Bank

73 The term loan with CIBC was still outstanding and it was important to keep the bank onside while 3M was exploring a potential transaction. Accordingly, Ashe sent out an email on April 25, 2002, immediately after the AiT Board meeting to Mauro Spagnolo, a vice-president of CIBC, to update the bank on the status of the discussions with 3M. This email states that:

> The discussions have been on a fast track. Since our first meeting on February 28, they have visited and completed the first phase of due diligence, we have visited them and completed the first phase of a pricing discussion. There have been numerous telephone conversations and exchange of information. They received the approval of their group VP last Tuesday April 16th and received the approval of the CEO on Monday April 22. We have

> been in a second phase of a pricing discussion since Monday and today our Board agreed to a price of $2.88 per share or CDN $42.6M for the company.

74 Subsequent testimony revealed that some of the content of this email was inconsistent with the events that took place. With respect to the statement that 3M received approval from the Group VP on April 16, and approval of the CEO on Monday April 22, there is no corroborating evidence, documentary or otherwise, that demonstrates that approvals were given on this date. Further, when Ashe was questioned about these approvals, he testified that he could not recall who had informed him of the approvals. Because the purpose of the email appears to be an attempt to convey a level of comfort to the bank that it would be paid out, we give little weight to this email when considering the evidence as a whole (see paragraph 112 infra).

11. The LOI: April 26, 2002

75 On April 26, 2002, Ashe signed the LOI on behalf of AiT, after a few changes were made to the text at the suggestion of Weinstein and her associates at LaBarge Weinstein.

76 In view of the importance of the LOI to this hearing and the relevance of its content, the entire text of the LOI is set out below:

> Dear Mr. Ashe:
>
> This letter confirms our mutual understanding with respect to a proposal by 3M Company ("3M") for the purchase of the outstanding capital stock of AiT Advanced Information Technologies Corporation ("AiT"). The purchasing entity shall be 3M Company and/or one or more of its affiliates.
>
> 1. Based upon the data furnished by you regarding AiT, 3M is prepared to offer CAD $2.88 for each fully diluted share of common stock of AiT. We have assumed in formulating this level of value that the stock is sold to 3M under similar Balance Sheet conditions and levels as shown in AiT's most recent quarterly filing with the Canadian Securities Administrators.
>
> 2. 3M currently has adequate resources to fund the purchase price as well as the ongoing working capital needs. As such, there is no financing contingency associated with this transaction.
>
> 3. Any agreement for the purchase of the stock of AiT is subject to a favorable due diligence review by 3M that is to be completed prior to 5:00 pm Eastern Time on May 13, 2002. This review will include, but is not limited to, a review of AiT's business operations, research and development, manufacturing, financial, legal, environmental and regulatory matters. A definitive purchase agreement will also contain representations, warranties and covenants which are usual and normal in a transaction of this type and size.
>
> 4. (a) In consideration of 3M's continued evaluation of a potential transaction with AiT, and as an inducement for 3M to continue to expend

time and incur expenses in connection therewith, AiT agrees that it shall immediately cease and cause to be terminated all existing discussions, negotiations and communications with any persons with respect to any Acquisition Proposal (as defined below). From the date of this letter until May 24, 2002, the Company shall not, and shall not permit any of its Representatives (as defined below) to, (i) solicit, initiate, consider, encourage or accept any Acquisition Proposal or (ii) except as provided in paragraph 4(b), participate in any discussions, negotiations, or other communication regarding, or furnish to any other person any information with respect to, or otherwise cooperate in any way, assist or participate in, facilitate or encourage any effort or attempt by any other person to make, any Acquisition Proposal. It is understood that any violation of the foregoing restrictions by any of the AiT's Representatives, whether or not such Representative is so authorized and whether or not such Representative is purporting to act on behalf of AiT or otherwise, shall be deemed to be a breach of this obligation by AiT.

(b) Notwithstanding anything to the contrary in paragraph 4(a) above, nothing herein shall prohibit AiT from furnishing information regarding AiT to, or entering into discussions or negotiations with, any person in response to an unsolicited "Superior Offer" (defined to be an offer to purchase each fully diluted share of common stock of AiT, payable in cash or freely marketable securities of a third party, at a price of not less than $3.20 per share) that is submitted to AiT by such person (and not withdrawn) if (a) neither AiT nor any of its Representatives shall have breached or taken any action inconsistent with any of the provisions set forth in paragraph 4(a) above, (b) the board of directors of AiT concludes in good faith, after considering the written advice of its outside legal counsel, that such action is required in order for the board of directors of AiT to comply with its fiduciary obligations to AiT's shareholders under applicable law, (c) AiT complies with its obligations to 3M under paragraph 4(c) below, and (d) AiT receives from such Person an executed confidentiality agreement in substantially similar form and content to the Confidential Disclosure Agreement dated March 12, 2002 between the parties hereto.

(c) AiT shall promptly advise 3M of AiT's receipt of any Acquisition Proposal and any request for information that may reasonably be expected to lead to or is otherwise related to any Acquisition Proposal, the identity of the person making such Acquisition Proposal or request for information and the terms and conditions of such Acquisition Proposal. AiT agrees to give 3M the right to respond to any Superior Offer before concluding negotiations with any person making the Superior Offer.

(d) "Acquisition Proposal" means any proposal or offer from any person (other than 3M or one or more of its affiliates) (i) relating to any direct or indirect acquisition of five percent or more of any class of

capital stock (or securities exercisable for or convertible or exchangeable into five percent or more of any class of capital stock) of AiT or any of its direct or indirect subsidiaries, or five percent or more of any class or series of debt securities of AiT or any of its direct or indirect subsidiaries, or all or a substantial portion of the assets of AiT or any of its direct or indirect subsidiaries, (ii) to enter into any merger, consolidation or other business combination with AiT or any of its direct or indirect subsidiaries or (iii) to enter into any other extraordinary business transaction (including, without limitation, any reorganization, recapitalization, liquidation, dissolution or similar transaction) involving or otherwise relating to AiT or any of its direct or indirect subsidiaries.

(e) "Representative" means, as to any person, such person's affiliates and its and their directors, [officers], employees, agents, advisors (including, without limitation, financial advisors, counsel and accountants) and controlling persons.

(f) As used in this letter agreement, the terms "person" shall be interpreted broadly to include, without limitation, any corporation, company, partnership, limited liability company, other entity or individual, as well as any group [or] syndicate that would be deemed to be a person under the law.

5. Both parties undertake to retain in confidence the existence of this letter and no written or oral announcement of the transaction will be made. This letter agreement is to remain confidential pursuant to the terms of the Confidential Disclosure Agreement dated March 12, 2002 between the parties hereto.

6. 3M's obligation to close the transaction shall be conditioned upon the AiT shareholders, listed in Schedule I, entering into Voting and Stock Option Agreements in favor of the approval and adoption of the transaction, subject to customary limitations and conditions. This indication of value and letter is understood as non-binding and subject to the approval of the appropriate management committees and the board of directors of 3M, as well as any applicable government agencies and the termination or waiver of any AiT Shareholder Rights Plans. Notwithstanding the foregoing sentence, 3M and AiT hereby agree that paragraphs 4 and 5 hereof and this paragraph 6 are binding. Accordingly, you should not make any business decisions in reliance upon this letter or the successful consummation of the proposed transaction. If, for any reason, 3M and AiT are unable to consummate the transaction or to pursue further negotiations, neither 3M nor AiT shall have any liability or obligations to each other and each party shall pay its own costs and expenses.

If the foregoing meets with the approval of AiT, we are prepared to proceed with our due diligence review and other actions necessary to complete a transaction, with a target signing date not later than May 24, 2002. We look

forward to receiving your response within five (5) days from the date of this letter, otherwise consider this letter withdrawn.

Very truly yours,

3M COMPANY

By: "*Ronald A. Weber*"

Ronald A. Weber

Executive Vice President, Transportation, Graphics & Safety Markets

Acknowledged this 26th day of April, 2002

Advanced Information Technologies, Inc.

By: "*Bernard J. Ashe*"

Bernard J. Ashe

President & CEO

12. The Insider Trading Warning Letter: April 26, 2002

77 After the AiT Board meeting on April 25, 2002, Ashe and Weinstein discussed that it would be prudent to inform anyone working on the due diligence from this stage forward that they would need to maintain their knowledge and information as confidential and not engage in any trading or tipping or communication regarding the 3M discussions.

78 Michael Dunleavy ("Dunleavy"), a lawyer at LaBarge Weinstein was charged with the task of preparing this document (the "Warning Letter"). The purpose of the Warning Letter was to ensure that the people involved in the due diligence, and the people who had any knowledge or involvement in AiT's discussions with 3M understood their obligations of confidentiality and their obligations not to trade or communicate anything that they knew. The Warning Letter addressed the Act's prohibitions on trading contained in section 76 of the Act.

79 On April 26, 2002, the Warning Letter was circulated to the insiders of AiT and the members of the due diligence team. Ashe personally addressed the Warning Letter to all the recipients. In addition, Ashe met one on one with each of the individuals to explain the Warning Letter and its implications.

13. The Second Due Diligence Visit: May 7, 8 and 9, 2002

80 AiT received 3M's second due diligence checklist on May 1, 2002, which outlined the issues to be discussed and addressed during the second due diligence visit. The checklist requested information regarding: financial information, tax filings and related tax information, sales and marketing, manufacturing, service, research and development, employees (organization, benefits, compensation), intellectual property, general legal agreements and commitments, real estate, environmental issues, health and safety, and AiT's information technology operating environment.

81 AiT had previously prepared due diligence binders for the first due diligence visit on March 26, 27 and 28, 2002; however, the volume of information required by the May 1, 2002 checklist was much greater. During the second due diligence visit, AiT needed to compile information regarding their policies and procedures for managing their employees. Other concentrated areas at the due diligence session included product demonstrations and looking at a more detailed level of source code; customer issues regarding agreements and relationships; financial statements; and, some integration planning with respect to the compatibility of their businesses on the issues of managing employees, business culture and values.

82 On May 7, 8 and 9, 2002, the second due diligence visit took place in the offices of LaBarge Weinstein and AiT. Close to 20 people attended this session on behalf of 3M, including a new group from 3M Canada.

14. The Rumours Circulating at AiT and the Telephone Call from RS

83 During the second due diligence visit, the presence of 3M personnel on site at AiT led to internal rumours of an impending acquisition. Ashe was made aware by Roseann Vaughan ("Vaughan"), an administrative assistant at AiT, that rumours were being circulated by AiT employees that 3M was buying AiT. The affidavit of Vaughan, sworn September 9, 2007, confirmed that she drafted an email to alert Ashe to this fact on May 9, 2002.

84 On May 9, 2002, AiT received a phone call from Bert De Souza ("De Souza") from Market Regulation Services Inc. ("RS") regarding an unusual increase in the trading volume and price of AiT shares. Wendy Smith ("Smith"), took the call at AiT and was informed by De Souza that AiT's stock was at a 52 week high and volume had also increased. Smith informed De Souza that AiT did not have any news and was not planning on sending any news out.

85 Smith called Dunleavy to report the RS discussion. Dunleavy then called RS and left a voice message for De Souza explaining that AiT was in discussions to be "potentially acquired". Dunleavy informed RS of some aspects of the transaction, for example, that there was a non-binding LOI and that they were in the process of due diligence. Dunleavy also stated that they were at a formative stage and would have nothing to announce until later in a couple of weeks.

86 Dunleavy also spoke to another employee at RS, and it was suggested that based on the trading activity in AiT's shares, it would be best to issue a press release. A draft press release was prepared by Dunleavy, which was circulated by email to in-house legal counsel at 3M, 3M's Canadian counsel and Ashe for comments. The final version of the press release was sent to De Souza, who approved it.

87 At the end of the day on May 9, 2002, after trading had closed, AiT issued a press release entitled "AiT Comments on Recent Stock Activity." It stated that AiT was "exploring strategic alternatives that would ultimately enhance value

for our shareholders." It further stated that AiT had "no further announcements to make at this time and do not intend to provide updates in respect of this process as we consider the various alternatives available to AiT." No material change report was filed with respect to the press release.

15. The Negotiation of the Merger Agreement

88 After the signing of the LOI, Ashe requested Dunleavy to prepare a first draft of a pre-acquisition agreement as a way to move the potential transaction forward.

89 On April 29, 2002, Dunleavy emailed Ashe a draft of the agreement. On April 30, 2002, Dunleavy emailed the draft of the agreement to Kim Price ("Price") and Roger Larson ("Larson") at 3M. In this draft agreement, the proposed transaction was structured as a take-over bid for AiT with 3M offering to purchase all of the issued and outstanding AiT shares, consistent with the LOI.

90 In the period between April 30, 2002 and May 14, 2002, AiT waited for a response from 3M. On May 2, 2002, there was a preliminary phone discussion relating to the proposed agreement. On May 7, 2002, Price informed Dunleavy that having an agreement by May 14, 2002 was too aggressive, and on May 8, 2002, Dunleavy was informed that the proposed deal would be structured as an amalgamation, and that AiT should receive 3M's draft of the proposed agreement by May 14, 2002.

91 On May 14, 2002, 3M provided AiT with their own draft merger agreement ("Merger Agreement"). This was a new document and it was a different document from the one that Dunleavy had initially provided to 3M.

92 Many changes were made during the negotiation of the definitive version of the Merger Agreement. Some of the major changes on the draft agreement included the treatment of employees and the break-up fee. 3M was agreeable to making the changes that AiT suggested on these issues. Approximately 10 drafts went back and forth during the negotiation process to reach the final Merger Agreement. The structure of the transaction ultimately took the form of an amalgamation for tax reasons, so that the merged company could utilize AiT's tax losses.

16. The Support Agreements

93 The delivery of signed support agreements by major shareholders of AiT was also a condition for the execution of the Merger Agreement. There was some concern that the requirement of putting appropriate support agreements to third parties would potentially delay the process, and on May 15, 2002, Dunleavy requested a copy of the support agreement to move the process along.

94 On May 17, 2002, Dunleavy received a draft of the support agreement. At this time, there were two problems with the agreement, in particular the inclusion of an atypical non-competition clause and the omission of the negotiated

term in the Merger Agreement that provided an out if there was a superior offer above an agreed price.

95 Through negotiation, 3M accepted AiT's position on these two issues, and the support agreements were revised and signed contemporaneously with the Merger Agreement. The support agreements represented 38.8 % of the outstanding common shares, including 29.7 % controlled by the directors and senior officers of AiT.

17. The 3M Approval Process

96 On May 14, 2002, the board of directors of 3M approved the acquisition of AiT subject to the approval of the CEO of the due diligence report and the integration plan. It is evident from Price's affidavit that a number of assessments (as part of the Blue Book Process) took place between May 14 to 20, 2002, including: sales and marketing assessment, manufacturing assessment, finance assessment, R&D assessment, IT assessment, real estate assessment, service assessment, insurance assessment, human resources assessment, environmental health and safety assessment, and office of intellectual property assessment.

97 On May 21, 2002, the due diligence report and integration plan was completed. On that date, the 3M CEO also gave final approval of the transaction following the meeting of the Corporate Operations Committee held to consider the matter and the approval of the report and plan.

18. AiT Board Approval of the Merger Agreement

98 On May 22, 2002, the AiT Board approved the definitive Merger Agreement and related documents and received a fairness opinion from CIBC Investment Banking, which concluded that the consideration offered to the shareholders of AiT in connection with the Merger Transaction was fair, from a financial point of view, to shareholders. At this time, AiT's shareholder rights plan was also waived. These events are reflected in the minutes of the May 22, 2002 AiT Board meeting:

> NOW THEREFORE BE IT RESOLVED THAT:
>
> 1. The entry by the Corporation into the Agreement, the Transition Agreement and the performance by the Corporation of its obligations under those agreements (and the amalgamation agreement contemplated in the Agreement) are in the best interests of the Corporation and its shareholders and the consideration to be received by the shareholders of the Corporation from 3M, as contemplated by the Agreement is fair; and
>
> 2. The entry by the Corporation into the Transition Agreement and the Agreement as placed before the Board of Directors, including the form of amalgamation agreement contemplated in the Agreement, is approved and the President and Chief Executive Officer of the Corporation is authorized for and on behalf of the Corporation to sign

> the Agreement with such changes from the version approved by the Board as he determines to be necessary or desirable; and
>
> [...]
>
> 4. Conditional on the prior execution of the Agreement, the Shareholder Rights Plan Agreement (the "Rights Agreement") between the Corporation and CIBC Mellon Trust Company, as Rights agent thereunder, dated February 20, 1998, and all of the Rights (as defined in the Rights Agreement) granted thereunder shall be deemed not to apply to the Amalgamation and shall terminate for no consideration without any act or formality on the part of a holder thereof on the effective date of the Amalgamation (and, without limiting the generality of the foregoing, no Flip-In Event or Separation Time (as those terms are defined in the Rights Agreement) shall be considered to have arisen as a result of the Amalgamation); and
>
> [...]

99 On May 23, 2002, AiT and 3M executed the definitive Merger Agreement. On the same day, AiT issued a press release and subsequently filed a material change report announcing that it had entered into the definitive Merger Agreement.

19. AiT Shareholder Approval of the Merger Transaction

100 The process called for by the Merger Agreement required AiT to hold a shareholders meeting to approve the amalgamation of AiT with 3M. A special meeting of shareholders was held on July 15, 2002 for this purpose. The shareholders approved the transaction.

101 The Merger Transaction closed on July 19, 2002, and a press release was issued and a material change report was filed by AiT.

B. Evidence Relating to Disclosure, Commitment and the Likelihood of Implementing the Proposed Transaction

102 During the hearing, we heard and considered evidence from six witnesses, including Ashe, Michael Prior, Dunleavy, Damp, Philip Anisman ("Anisman") and Peter Dey ("Dey") (the latter two were expert witnesses). In addition, Weinstein also testified on her own behalf.

103 We also received in evidence affidavits from Lumley, Macmillan, Price and Vaughan.

1. The Witnesses

i. Ashe

104 Ashe was the president and CEO of AiT during the time period when AiT was involved in negotiating the Merger Transaction with 3M. In addition, Ashe was a member of the Valuation Committee and the Strategic Committee. During the hearing, he gave testimony regarding the detailed chronology of the events

surrounding the Merger Transaction, and he also provided testimony regarding the issue of disclosure and commitment of AiT and 3M.

105 With respect to the issue of disclosure, Ashe testified that on April 25, 2002, disclosure issues were discussed at the AiT Board meeting. He recalled that Weinstein mentioned that there was no obligation to disclose because the proposed deal was non-binding and numerous conditions existed that were beyond AiT's control. At this time there was still the issue of 3M approvals and AiT did not have any documents at this point. Ashe testified that he thought that AiT's disclosure obligations would arise when there was commitment from 3M.

106 Ashe also gave testimony relating to his understanding of the situation at the time the LOI was signed. He testified that there did exist some uncertainties as to whether the proposed deal would work out. These uncertainties included: concluding the second due diligence phase; concluding definitive purchase and sale agreements; getting approval from 3M's executive committee and board; and 3M's concluding of its Blue Book Process.

107 As for the drafting of the proposed Merger Agreement, Ashe testified that at the time the document was being drafted, issues arose regarding severance and AiT's obligations to its employees and the break fee. However, 3M was ultimately amenable to AiT's suggestions on these issues.

108 During cross-examination, Ashe explained that on May 14, 2002, when he received the draft Merger Agreement from 3M for the first time, he did not know at that time whether the negotiations would go smoothly. As well, Ashe conceded that the issue of the break fee was an important issue to be resolved. Counsel for Weinstein referred Ashe to Dunleavy's email dated May 15, 2002, which stated that "the timing of the break fee is a crucial point" and "AiT is simply not in a position to fund this commitment if the second transaction does not close for some reason". Ashe admitted that it would be a difficult issue for AiT to secure the amount of the break fee.

109 In addition, Ashe admitted that he could not imagine completing the deal by not paying severance to terminated employees and by having employees agree to sign up to conditions where they waived their termination rights under existing change of control provisions. In hindsight, Ashe agreed that issues like severance and the break fee could have been deal breakers if they were not resolved during the negotiation process.

110 With respect to the drafting of the agreement, Ashe testified that 3M did not work with the draft agreement that AiT sent them, and that 3M had their own way of doing things.

111 During cross-examination, Ashe also revealed that the minutes of the April 25, 2002 AiT Board meeting were not prepared until the period between June 27 and July 4, 2002.

112 He also admitted that during the negotiations with 3M he never spoke with the CEO of 3M and never received any indication from the CEO of 3M that the deal was approved. Similarly, Ashe testified that he never spoke directly to Weber, the 3M Executive Vice-President.

113 Further, during cross-examination, Ashe testified that the support agreements were negotiated starting on May 17, 2002 and the negotiation lasted over a few days. Ashe also admitted that the exclusion of the non-compete and the addition of an opt-out provision were provisions that had a material influence on whether key shareholders would sign the support agreements.

ii. Damp

114 Damp was a director of AiT. He testified that after the execution of the LOI on April 26, 2002, his personal view was that AiT had reached the first major gate in the process, had a reasonably good chance of a deal, but believed there were still a number of factors that could cause the transaction not to happen at all, or that 3M would not be prepared to proceed at the price agreed to on April 25, 2002.

115 According to Damp, 3M was trying to get AiT to a price that the significant shareholders would be willing to accept on April 25, 2002. He also testified on cross-examination that there was a good-faith expectation that both AiT and 3M were working towards negotiating and completing a transaction.

116 In his testimony, Damp discussed what he felt were the remaining gates to be reached in getting the LOI to a definitive agreement. These included:

- Harrold was a mid-level manager who would have to obtain a series of corporate approvals to get the transaction completed, including the CEO of 3M and the board of directors. He felt it was unpredictable how each level of management would view the transaction, simply because 3M was a large corporation that made many acquisitions and AiT was a small company that was likely inconsequential to 3M. It was Damp's belief that 3M was looking at other acquisitions other than AiT;
- Damp found the human resources aspect unpredictable in all mergers and acquisitions, especially in high-tech companies where acquirers often wanted assurance that employees would stay with the company after the transaction. Damp testified that AiT was especially vulnerable because Alan Boate, the head of research and development and the "brain power" of AiT, was unhappy with the discussions. Boate was "acting in an emotional and erratic way" and Damp was concerned Boate would "denigrate the management team, denigrate the activities of [AiT]" during the due diligence process;
- AiT had presented aggressive financial forecasts for 3M to use during the first due diligence process, and Damp expected that there would be a full review of the forecasts by 3M's finance team who would challenge

the assumptions. He was concerned that there would be a credibility issue with the attainability of the forecasts and a resulting price reduction; and

- There was a due diligence process that had to be done regarding tax losses.

117 Damp also testified that AiT had negotiated a very good price with a significant premium, and although 3M seemed willing to proceed towards that price, he felt it was vulnerable to a review by 3M because of the typical reluctance of big companies to pay premiums that were viewed as too high.

118 On the issue of disclosure, Damp recalled that there was a general discussion amongst the directors at the AiT Board meeting on April 25, 2002, where Weinstein had advised that disclosure wasn't required based on the fact that the LOI was non-binding. Damp also testified that he relied on and agreed with Weinstein's legal advice regarding disclosure, and that she did not mention the possibility of confidential disclosure to the Commission.

119 In Damp's view, the AiT Board approved the proposed transaction on May 22, 2002. On this date, a number of significant issues for the AiT Board were resolved at this time, for example, the due diligence was complete, 3M was ready to proceed, the negotiation of significant terms was completed and the AiT Board reviewed the Merger Agreement after a presentation and discussion on it.

120 In his testimony, Damp also commented on the situation that would probably have occurred if the potential transaction with 3M was not completed. He was of the view that AiT's business plan would have involved continuing in its core ID business, which was still viable and profitable for AiT, and shutting down Affinitex to save money. In addition, Damp testified that the formal M&A process that AiT had postponed to pursue the transaction with 3M would have been recommenced, to survey whether there were any other organizations that were interested in acquiring AiT. Damp believed the main issue that AiT had with their bank loan was the cash flow that was going into Affinitex, and he was of the opinion that AiT's business would have been able to move forward once they were able to cut those losses.

iii. Dunleavy

121 Dunleavy was not involved in the AiT-3M negotiations until the execution of the non-binding LOI. His testimony focused on his perspective of the transaction between that date, April 26, 2002 and its closing. When asked what his knowledge of the status of negotiations with 3M on April 26, 2002 was, Dunleavy testified:

> Well, obviously, we had received a letter of intent. And it, in typical fashion, created an obligation on AiT not to proceed with any other acquisitions for a period of time of 30 days while the parties continued their discussions.

> It did have a price of [$]2.88 per share that was the proposed price. It did have other provisions that would have permitted — that were negotiated into the document that would have permitted AiT to back out of the restriction on considering alternative transactions if an alternative transaction of a superior nature came in.
>
> So at that point, I knew that we had reached a juncture of the transaction that the parties felt that they want to begin a legal process. It didn't necessarily mean that we would conclude a transaction in the end.
>
> But the parties were willing to take the next step, which was to engage in the more complete due diligence, and to see if they could negotiate a transaction to close at the end of the day.

(*Hearing Transcript in the Matter of AiT Information Technologies Corporation, Bernard Jude Ashe and Deborah Weinstein*, dated September 17, 2007 (the "*Sept. 17 Transcript*") at 20:15 to 21:10)

122 Dunleavy felt that the primary purpose of an LOI was only for the buyer to obtain a lock-up of the target company to make its assessment of whether to make the acquisition. Dunleavy also testified that it was his view that the approval at the AiT Board meeting on April 25, 2002 was merely to proceed with discussions with 3M by moving to an LOI, and approving a target ceiling price of $2.88 per share. Dunleavy explained that in his experience, he treated a price listed in an LOI as a ceiling price because it usually meant that the parties were willing to move forward at the given price, notwithstanding that it could potentially be driven down after due diligence and other factors. In his experience, terms of an LOI were often modified substantially once parties entered the due diligence process. However, Dunleavy also testified that during the negotiations with 3M, the parties did not revisit the issue of price.

123 According to Dunleavy, the first 10 days after the execution of the LOI were slow; AiT was taking steps to try to move the deal forward, but received few responses from 3M. This included sending a draft of an acquisition agreement to Price at 3M on April 30, 2002. Dunleavy testified that it was not typical for acquirees to produce the first draft of such agreements, and further that it was often the case that acquirers would present an acquisition agreement draft very soon after the LOI had been signed. Dunleavy testified that by the first few days of May, he felt that either 3M was not as interested as he thought, or that 3M was going to take its time in doing the transaction despite that they only had an exclusivity period for 30 days. On May 7, 2002, Price communicated to Dunleavy that having an agreement by May 14, 2002 was too aggressive.

124 Dunleavy testified that after a preliminary call on May 2, 2002, discussions about the structure of the transaction did not take place until a conference call on May 8, 2002, where he was first informed that the deal would be in the form of an amalgamation. Dunleavy was also informed by 3M at that time that he would be receiving a draft acquisition agreement by May 14, 2002. It was in this draft of the Merger Agreement from 3M that the structure of the transaction was con-

firmed as an amalgamation. In his view, the structure of the transaction could potentially have had a material impact on the tax treatment and economic value of the transaction to AiT shareholders which may in turn have impacted AiT's willingness to proceed.

125 On May 9, 2002, Dunleavy felt he was accurate about the status of negotiations with 3M when he spoke to RS and characterized the negotiations as at a nascent stage. At this time, he believed that due diligence was still ongoing; the deal structure was not confirmed; a draft agreement had not been received; and, 3M board approval had not been obtained.

126 Dunleavy also testified that he was not part of the discussions regarding the 3M approval process. He had no idea what the process was, other than that it was highly complicated and bureaucratic, and he was not informed about the status of the approvals.

127 With respect to the issue of disclosure, Dunleavy testified that he agreed with Weinstein that usually circumstances do not require disclosure of a non-binding LOI in the context of a merger and acquisition transaction. Although he didn't believe disclosure only occurred when there was a final binding agreement, he felt it was very typical for disclosure to occur at that time. From his experience, it was often only when such an agreement was signed that there were sufficient indicators of commitment to trigger the obligation.

iv. Weinstein

128 Weinstein testified that she became aware of the discussions between AiT and 3M regarding a potential acquisition around March 1, 2002. Ashe informed her that he had been speaking with someone at 3M and that there could be a potential interest in the company.

129 Subsequently, Weinstein became involved in the discussions with 3M and became involved with the process to review the confidentiality agreement. According to Weinstein, "[it] took seven days to negotiate what I would have considered to be fairly standard provisions." Weinstein's testimony also demonstrated that through negotiating the confidentiality agreement 3M's bureaucracy and way of conducting business became apparent.

130 Weinstein also testified that she was aware that the CEO of 3M followed the Six Sigma process. With respect to this, Weinstein explained that:

> And so as — I found it very surprising that they had these levels, but I wasn't surprised by the bureaucracy, and I — it sort of gave me a sign of, I think, what I expected to come and, in fact, what did come.

(*Hearing Transcript in the Matter of AiT Information Technologies Corporation, Bernard Jude Ashe and Deborah Weinstein*, dated September 19, 2007 (the "*Sept. 19 Transcript*") at 101:24 to 102:3)

131 After the confidentiality agreement, Weinstein testified that she and LaBarge Weinstein were involved with the preparation for the due diligence process. She also testified that she advised AiT regarding disclosure obligations. In particular:

> So I wanted to ensure that [Ashe] understood the importance of confidentiality. We would not want premature disclosure at a preliminary stage. And so I would have provided him, as [Dunleavy] would have, with advice around the stages of a transaction, in a very general way at this point, because we had no idea what to expect from them. And as a lawyer, always reminding him of the various obligations of a public company.

(*Sept. 19 Transcript, supra* at 103:23 to 104:5)

132 From the period of March 26 to April 8, 2002, Weinstein was away on vacation. Upon return from her vacation, she attended the meeting in St. Paul with 3M on April 11 and 12, 2002. According to Weinstein, her role at this meeting was to assist Damp and Ashe and she explained that:

> And it was my understanding that going down there was to continue to sell them on our technology, our people, our assets, and try to get them interested in moving towards a price.

(*Sept. 19 Transcript, supra* at 107:6-9)

133 At the time of the meeting in St. Paul on April 11 and 12, 2002, Weinstein recalled that she was unsure whether 3M was serious about acquiring AiT:

> So reading the annual report, I was — I was very pessimistic that they were actually interested in buying us. I thought they were interested in learning about our technology.
>
> They had — they had a big organization, and they had a lot of smart people, and it's been my experience with high-technology companies that a lot of people do a lot of shopping of the kinds of technologies and the kinds of vision and strategy small — smaller, agile companies have. But there's this philosophy of 'not in my backyard', which is a lot of technology companies have engineers who say, no, we don't have to acquire it. We can do it ourselves.
>
> So I was a skeptic.

(*Sept. 19 Transcript, supra* at 108:10-23)

134 In addition, Weinstein testified that it was unclear if AiT was negotiating with someone at 3M who had authority:

> I never really knew who I was talking to. I mean, Steve Harrold was there [...]
>
> But all of the purse strings and all of the authority for making the business decision on whether to acquire is made by corporate development people.

> And I also recall in that annual report, there were over a hundred officers mentioned at the back of the annual report. Steve Harrold wasn't one of them.
>
> And so I was concerned that we — I didn't know who we were negotiating with.

(*Sept. 19 Transcript*, *supra* at 109:5-18)

135 Weinstein also testified that 3M made it very clear to AiT that any negotiation regarding a price range would be subject to a non-binding letter of intent and board approval.

136 Following the meeting in St. Paul, Weinstein was of the view that a number of uncertainties existed as to whether the negotiations with 3M would be successful. These uncertainties dealt with the issue of 3M not being interested in Affinitex, tax issues and the structure of the deal itself. According to Weinstein:

> [3M] kept suggesting they were going to buy assets, and that was just going to be a horrendous after-tax result for our shareholders, and I believe would not be of — supportive of our principal shareholders.

(*Sept. 19 Transcript*, *supra* at 111:25 to 112:3)

137 With respect to the phone call between Ashe and representatives from 3M on April 23, 2002, Weinstein's view (although she was not a participant in the call) was that this call was a step in the direction of working towards the proposed transaction. It is her recollection of being advised that there was a price 3M had in mind, and if the AiT Board was supportive of that price range, then 3M would move to the next stage. She saw this step as a precursor to the next stage of preparing a non-binding LOI, with which the proposed transaction would begin what she considered to be a standard process.

138 Weinstein was not involved with the call that took place on April 24, 2002; however, she was updated by Ashe with respect to the pricing discussions.

139 Weinstein also gave testimony regarding the AiT Board meeting on April 25, 2002. In her view, the purpose of this meeting was the following:

> [...] that in order for [3M] to proceed to begin to expend resources and go through their in-depth process, they would have to know that our board would be open to receiving an offer at $2.88.
>
> And I took that to mean that it wasn't a definitive offer of [$]2.88 that day. It was that should they go through their process and come out the other side, that, as Mr. Dunleavy said, if [$]2.88 was, again, offered to them after all the negotiations, after all the due diligence, after all the definitive agreements, that our board would look positively on that.
>
> And so I looked at it as a precursor. And they wanted to know back from Mr. Ashe if our board was inclined to allow them to continue the process.

(*Sept. 19 Transcript, supra* at 119:4-17)

140 According to Weinstein this meeting was held because the AiT Board needed to give its approval to allow Ashe to continue with the negotiations with 3M. Specifically, Weinstein stated:

> [...] an officer should not commit the company to a process that might result in an offer, a friendly negotiated offer, without the board allowing him to continue the process.
>
> And so in my mind, whether it was a verbal of [$]2.88 or whether it was — and there are many different ways one can do it, an expression of interest, a memorandum of understanding, a non-binding LOI. You can call it whatever you want.
>
> When you start to move into the disruptive process that we were about to enter into, it would — it is always appropriate that the board sanction that move.

(*Sept. 19 Transcript, supra* at 119:25 to 120:11)

141 In her testimony, Weinstein also described her recollection of what was discussed during the AiT Board meeting of April 25, 2002:

- "[Ashe] would have discussed the — the prior two days and how we came to the $41-million, and he would have discussed that we were expecting a non-binding LOI after the board meeting and after he was able to advise 3M that the process could continue." (*Sept. 19 Transcript, supra* at 120:21-25)
- "There would have been — or there was discussion, as Mr. Damp alluded to, about the price. Obviously, we were all there trying to maximize shareholder value. And wanted to be sure, when you undertake a non-competitive process — this wasn't an auction; there was a one-on-one negotiation — that the board — every board member had to feel confident and sure that there wasn't another amount of money that was available for the shareholders." (*Sept. 19 Transcript, supra* at 121:1-9)
- "After that discussion and [Ashe's] overview of what he had been advised were the next steps, I would have, in my role as legal counsel, provided an overview of the various legal ramifications of what we were about to enter into. I would have talked about communications, i.e. don't communicate, and the confidential nature." (*Sept. 19 Transcript, supra* at 121:10-15)
- "I was asked about what kind of public disclosure was required, if any. And it was my opinion then and still is my opinion today that we did not have a change, and I would have advised the board or I did advise the board that no public disclosure was necessary." (*Sept. 19 Transcript, supra* at 121:16-20)

- "So we were — albeit all coming from a different perspective, we were united on what the facts were. And based on those facts, my analysis of the law was that there was no material change." (*Sept. 19 Transcript, supra* at 121:25 to 122:3)
- "We would have talked about the timing of the evolution, the various approvals and commitments that we still needed to obtain, but that we had a lot of work to do around due diligence, negotiation of every agreement and every term. And the participation of myself and [Ashe] in that — myself as legal counsel and [Ashe] and the rest of the management team." (*Sept. 19 Transcript, supra* at 122:12-18)
- "We would have talked in general terms that they were going — that we had not resolved how they were going to buy the company, if, in fact, they ended up buying the company or making an offer to buy the company, and we would have talked about the due diligence that was required and the fact that we didn't have any paper at that point. We didn't even have a non-binding LOI draft. We didn't have anything." (*Sept. 19 Transcript, supra* at 122:22 to 123:4)

142 With respect to the prospect of whether the proposed transaction with 3M would be successful, on April 25, 2002, Weinstein recalled that there was some skepticism. She testified that:

> I think it's safe to say that we were all hopeful that we could convince 3M and manoeuvre our way through due diligence and their process and their bureaucracy to an end point.
>
> There was a lot of skepticism, but there was hopeful optimism, even though Mr. Sandler thought we were worth $100-million, or wanted, at least, to have the company be worth that value, I think inherently, we all knew that if we could achieve an outcome at $41-million, that that would be a very good outcome for shareholders. But there was healthy skepticism.
>
> [...]
>
> I recall being told at that time that their board would be looking to approve it on May 14. Again, I didn't have a letter of intent, so I thought, my goodness. There's so much work to be done. I reflected back on sort of the month or so in between.

(*Sept. 19 Transcript, supra* at 123:8 to 124:2)

143 Weinstein also explained that she did not believe 3M was committed to the transaction at that date, and if she thought 3M was committed at this time, then she would have advised the AiT Board to waive the shareholder rights plan. Weinstein explained that when a company is ready to commit and has committed to do a transaction, the board has to approve entering into the agreement. At this point, then the board waives the shareholder rights plan with respect to that agreement only. Next, the shareholders need to approve the transaction and waiving of the shareholders rights plan at the shareholders meeting to consum-

mate the transaction. Weinstein testified that the AiT Board did not waive the shareholders rights plan at the April 25, 2002 meeting. Specifically, Weinstein stated:

> [...] we had put in a shareholder rights plan, which is the legal equivalent to a poison pill, which permitted the board to have up to 45 days — that was about the proper range of time — to seek a superior offer, should a hostile bid come in.
>
> If our board had not waived that plan, we would have been offside and caused havoc in our shareholdings, because it's a mechanism that if the board doesn't waive it, your shareholders get thousands more shares for every share they hold.
>
> Had I thought we were entering into an agreement on April 25th, I would have had the board waive the pill on April 25th. Had I thought we were making a commitment on April 25th, I would have had the board do that.

(*Sept. 19 Transcript*, *supra* at 143:3-17)

144 Therefore, according to Weinstein, at this time, there was uncertainty regarding whether 3M was committed, and Weinstein explained that AiT did not have the "ability to implement or force 3M to purchase the company or commit to purchasing the company".

145 Weinstein also gave testimony relating to the support agreements. According to Weinstein:

> The individuals on the board had to confirm that as shareholders, they would sign the support agreement. Because the board meeting we held in April did not bind any of the board members to vote in favour of the transaction as a shareholder.

(*Sept. 19 Transcript*, *supra* at 142:14-18)

146 With respect to the minutes of the April 25, 2002 AiT Board meeting, Weinstein explained that the wording of the minutes is identical to the wording in the proxy circular and that they were both prepared in late June 2002. According to Weinstein, the minutes are accurate, but the characterization of what was approved is "less legal". She pointed out that the key words from the minutes are: "Subject to board approval by AiT, 3M would draft for execution by both parties a non-binding letter of intent to acquire all the shares as discussed." She explained that during the April 25, 2002 AiT Board meeting, Ashe advised the AiT Board that he received a verbal commitment from 3M to enter into a non-binding letter of intent, and this is what the AiT Board was approving.

147 In Weinstein's view there was no approval of the AiT Board to enter into a transaction at this time; it was only approval to continue the negotiation process with 3M, and if AiT had not given this approval on April 25, 2002, then the parties would have not been able to move to the next steps of negotiation. In particular, Weinstein took the view that there was no approval for the Merger Transaction with 3M prior to the AiT Board meeting on May 22, 2002.

148 On the subject of the LOI, Weinstein recalled that AiT received the draft LOI from 3M on April 26, 2002. In her view, the LOI was "very short, very non-binding", and it confirmed that negotiations should proceed based on a price of $2.88 per share. In her view, AiT did not have an agreement with 3M at this time and the effect of the LOI was as follows:

> The letter of intent merely had [3M] re-confirm their obligation not to use [AiT's] confidential information in accordance with the earlier confidentiality agreement. 3M had no other commitments at that time.

(*Sept. 19 Transcript, supra* at 126:8-11)

149 She also testified that in her view, the issue of the negotiation of price could be reopened by 3M and 3M could walk away at any time.

150 With respect to 3M's corporate approval process, Weinstein testified that the LOI mentioned that there were committee approvals, but at that time she did not know which committee approvals were required and she was not sure of the timing of that process.

151 On the issue of disclosure at this time, Weinstein was of the opinion that there was no obligation to disclose, and if there was, she would have spoken up and advised AiT accordingly. Weinstein also acknowledged that with respect to the confidentiality provisions "no contract entered into ever trumps statutory law."

152 Following the execution of the LOI on April 26, 2002, Weinstein testified that the next step in the negotiations with 3M was the preparation of the "pre-acquisition agreement", and her involvement during this process was to review the work of the lawyers at LaBarge Weinstein.

153 On April 26, 2002, Weinstein recalled that she spoke with Price and another individual from 3M regarding AiT's corporate structure. According to Weinstein, the purpose of this conversation was as follows:

> And I believe they needed to gather up a bunch of information, even preliminary to the due diligence, to try to figure out how they would entertain an acquisition, should they proceed with it.
>
> [...]
>
> And so from April 26 until the phone call with Kim Price and Jonathan Lampe, I think on the 8th, we would just provide them with whatever information they needed, I believe because they were trying to figure out how to potentially do the transaction within their own corporate makeup.

(Sept. 19 Transcript, supra at 130:12 to 131:1)

154 According to Weinstein, at this time AiT did not know what the structure of the transaction would be. She also testified that it is not up to the target (in this case AiT) to determine the structure of the transaction.

155 On cross-examination, Weinstein admitted that on April 26, 2002 there was material information that AiT was beginning a process with 3M, and that is why

the Warning Letter was prepared to warn insiders of AiT that they could be held liable under section 76 of the Act.

156 When asked about confidential disclosure, Weinstein explained that she did not turn her mind to confidential disclosure, because on April 25 and 26, 2002, there was no [material] change, and there were no terms that were definitive to put in a confidential material change report.

157 Also, during the second due diligence on May 7, 8, and 9, 2002, Weinstein recalled that at this time there were a number of existing concerns, including intellectual property, employee related issues and financial issues that could affect 3M's perception of AiT's value. Specifically, Weinstein was concerned that AiT's technology and source code would be outdated and not be compatible with other technologies used at 3M; that AiT's liability from previously issued warranties (as a result of doing their own manufacturing) was not sufficiently covered in their financial statements; that 3M would restructure or relocate AiT, resulting in significant layoffs of its employees; that 3M would view AiT's revenue projections to be too aggressive; and, the general concern that by buying all of AiT's shares, 3M would be picking up all of AiT's potential liabilities, including any patent infringement claims.

158 Weinstein recalled that on May 9, 2002 when she left to go on vacation the structure of the transaction was not settled; however, an initial structure had been discussed. Also, when she left on vacation on May 9, 2002, AiT had still not yet heard back from 3M regarding the draft acquisition agreement prepared by Dunleavy.

2. The Affidavits

i. Lumley

159 Staff read into evidence an affidavit sworn August 29, 2007, by Lumley, who was a director of AiT during the Relevant Period. In his affidavit, Lumley outlined his current and prior work experience outside AiT; his role as a director of AiT, his working relationship with Weinstein before he recommended her appointment to the AiT Board, and Weinstein's role in providing expertise and judgment with respect to legal issues in a public company context.

160 Lumley recollected the material events that occurred between April and June of 2002 surrounding the Merger Transaction. With respect to the discussion about disclosure at the AiT Board meeting on April 25, 2002, Lumley recollected that:

> I believe that I raised the issue of disclosure of the proposed 3M transaction as a normal question, a standard thing that I would ask at a Board meeting in such circumstances. I obtained information about the proposed transaction through Bernard Ashe or Deborah Weinstein at Board meetings. I accepted Deborah Weinstein's advice on the issue of disclosure. I don't recall any debate on the issue. While the AiT persons negotiating the deal were opti-

> mistic and it appeared to me that there was a strong possibility that the deal would be completed, I strongly worried whether the deal would fall away.

(*Affidavit of Edward C. Lumley*, sworn August 29, 2007, ("*Lumley's Affidavit*") at para. 10)

161 Lumley also stated that the disclosure discussion involved most of the AiT Board members and in particular "it was a serious discussion regarding the substantial chance that the transaction would not be completed and that premature disclosure could result in the failure of the deal" (*Lumley's Affidavit, supra* at para. 14).

162 He also relied heavily on the correspondence from his counsel in response to Staff inquiries made in July 2004 and February and July of 2005 to more accurately recollect the events. Specifically, this correspondence states:

> The Outside Directors recall that discussion took place during the Board meeting on April 25, 2002 as to whether the proposed transaction with 3M should be announced as a material change. It was the conclusion of the Board of AiT that it would be premature to announce a possible transaction with 3M at that time. As outlined above, the main reason for the Board arriving at that conclusion was the degree of uncertainty as to whether 3M would proceed with the transaction as proposed.
>
> It is the recollection of each of the Outside Directors that Deborah Weinstein, whose law firm LaBarge Weinstein was counsel to AiT and who was intimately familiar with the details of the negotiations with 3M, expressed her opinion that based on the non-binding nature of the letter of intent, it would be premature at that time to announce a possible transaction with 3M. [...]
>
> [...] The Outside Directors relied on Deborah Weinstein's advice in this instance that it would be premature to announce a possible transaction. Based on their understanding of the status of the discussions with 3M, they agreed with her advice.
>
> Due to the significant uncertainty as to whether the proposed transaction would proceed, the AiT Board, was mindful that the announcement of a possible transaction with 3M at that time could be misleading and cause turmoil in the market for AiT's shares, particularly in the event that the proposed transaction did not proceed. Such an occurrence would have damaged AiT and its shareholders. Furthermore, there was a realistic possibility that an announcement by AiT at that time would have terminated 3M's interest in reviewing a transaction, to the loss of AiT and all its-stakeholders.

(*Lumley's Affidavit, supra* at para. 8)

163 In addition, Lumley confirmed that the approval process at 3M was not automatic, instead there were a number of approvals that had to be given by higher

authorities within 3M. For instance, there was still the issue of getting 3M approvals as a part of 3M's Six Sigma process. Lumley recollected that:

> [...] there existed a real concern that the transaction would not be approved by higher authorities at 3M. In other words, approval at 3M was not a rubbert stamp process. I did question at Board meetings whether the potential transaction was real or not.

(*Lumley's Affidavit*, *supra* at para. 12)

164 Lumley also referred to AiT's deteriorating financial condition. In his view, "[at] this time, AiT was not in good shape [and] sales were falling" (*Lumley's Affidavit*, *supra* at para. 11).

165 Lastly, Lumley explained that he did not play an integral part in the transaction. He also referred to his experience in other take-over situations and his practice of relying on legal advice with respect to the issue of disclosure.

ii. Macmillan

166 Staff also submitted an affidavit from Macmillan, another former director of AiT during the Relevant Period, sworn September 10, 2007. In his affidavit, Macmillan outlined his current and prior work experience (in his work experience, he was not involved in disclosure decisions around securities transactions), his working relationship with Weinstein, how he became involved with AiT, and his recollection of the events surrounding the 3M transaction. Macmillan confirmed the financial difficulty that AiT was experiencing at the end of 2001, the failure of diversification strategies pursued by AiT, and the plan to retain an advisor to assist in exploring strategic opportunities before it was put on hold to pursue discussions with 3M.

167 Macmillan revealed his lack of involvement in the 3M negotiations beyond the occasional updates from Ashe and Weinstein and the AiT Board meeting on April 25, 2002. (*Affidavit of Graham Macmillan*, sworn September 10, 2007 ("*Macmillan's Affidavit*") at para. 6).

168 He did recall discussing at the April 25, 2002 AiT Board meeting the potential transaction with 3M and the AiT Board being satisfied that the price of $2.88 per share proposed by 3M was fair in the circumstances; however, he also recalled concern among the directors that 3M would change its mind about proceeding with the transaction because of AiT's poor financial performance. In particular, he states:

> Although the general mood was that this represented an excellent opportunity for AiT to maximize shareholder value, I recall that there was concern amongst the directors that 3M could change its mind at any time about proceeding with a transaction. We were cognizant of the fact that 3M was a multi billion dollar company and that AiT would not have been important to 3M. I was also of the view that with these kinds of transactions, the "devil is in the detail".

(*Macmillan's Affidavit*, *supra* at para. 18)

169 Macmillan also emphasized that there was a great deal of uncertainty surrounding the proposed transaction:

a) Whether 3M would require the agreement of the key technical personnel at AiT to continue to work for merged AiT/3M entity (in fact, Alan Boate, the Chief Technology Officer, did not agree to work for 3M);

b) There was discussion about whether the AiT research and development facility would be relocated by 3M from Ottawa to St. Paul, Minnesota. A decision to make such a move would undoubtedly have affected the willingness of key personnel to work for the merged entity;

c) There was a question as to whether 3M would want to discontinue the affinitex healthcare division and it was unclear how that would effect the proposed transaction; and

d) AiT's sales results for the first quarter of 2002 were poor, raising a question as to whether 3M would perceive that AiT would be unable to meet the revenue targets in the forecasts that formed the basis of the valuation discussions. (Macmillan's Affidavit, supra at para. 25)

170 In addition, Macmillan refers to correspondence to Staff dated July 25, 2004:

> At that time, [I] believed that there was a great deal of uncertainty as to whether a transaction could be concluded with 3M at the price discussed at the board meeting. [I] was extremely concerned that AiT's poor financial performance through that time period would derail the proposed transaction or lead to a renegotiation of the price, which may or may not have attracted the support of the major AiT shareholders.

(*Macmillan's Affidavit*, *supra* at para. 19)

171 With respect to the discussion about disclosure, Macmillan states that:

> I recall that there was discussion at the April 25 Board meeting respecting disclosure which lasted approximately 20 minutes. There was no dissent amongst the directors about the approach to disclosure.
>
> From my perspective, disclosure of the non-binding letter of intent would be premature from a business point of view. I looked to Ms. Weinstein for the legal point of view. At the time, I was generally familiar with the material change provision in the Ontario Securities Act but not with the provision which provides for a confidential disclosure to be made upon a material change.
>
> The main factors which indicated to me that disclosure would be premature included the fact that the letter of intent was non-binding, due diligence had to be performed by 3M, and I was not sure how AiT's recent quarterly financial results would affect 3M's opinion of the proposed transaction.

(*Macmillan's Affidavit*, *supra* at paras. 20 to 22)

172 Further, Macmillan also relied on his correspondence with Staff in July 2004 to confirm that the AiT Board relied on Weinstein's legal advice that disclosure would be premature based on the fact that the letter was non-binding, and that it would potentially terminate 3M's interest in the transaction, causing turmoil in the market and damage to AiT and its shareholders. This correspondence states:

> The AiT Board, including the Outside Directors, were made aware of the significant caveats contained in the letter of intent provided by 3M and they took those caveats very seriously. 3M is a massive corporation with annual revenues of US $16 billion. The AiT Board was aware that 3M reviewed numerous acquisitions and had its own procedures to assess and approve such transactions. It was apparent from the outset that it was going to be the "3M way or the highway". In terms of the discussions that AiT had with 3M regarding a possible transaction, AiT was aware that the primary 3M representative, Steven Harrold, was at a middle management level at 3M and did not have the authority to commit 3M to the acquisition of AiT or to otherwise cause 3M to commit to the proposed transaction. AiT was therefore aware that senior management at 3M could choose not to accept Mr. Harrold's assessment of the benefits to 3M of acquiring AiT.

(*Macmillan's Affidavit*, *supra* at para. 24)

173 Based on this information, Macmillan takes the position that "the advice that Deborah Weinstein gave to the AiT Board that disclosure would be premature at that time, appeared to [him] to be reasonable" (*Macmillan's Affidavit*, *supra* a at para. 26).

iii. Price

174 Counsel for Weinstein adduced into evidence an affidavit, sworn September 21, 2007, from Price, the Assistant General Counsel at 3M Company currently and at the material time. In her affidavit, Price outlined her involvement in the negotiations as the 3M representative primarily responsible for reviewing all legal matters in relation to the proposed transaction.

175 Price outlined the perspective of 3M on the status of the proposed transaction between April 26, 2002, the date the letter of intent was executed, and May 21, 2002, the date 3M corporate approvals were obtained. She relied on her correspondence to counsel of the merged 3M-AiT in July 2004, which was intended to be forwarded to Staff in response to inquiries regarding the transaction. In view of the relevance of this correspondence to the issue of commitment to the potential transaction by 3M, we have set out the relevant text:

> A letter of intent is, from the perspective of 3M, a reflection of our interest in pursing a commercial transaction if a number of substantive hurdles are cleared, including (among other things) completion of:
>
> - substantive due diligence,
> - integration and business planning,

- internal review by the board and other members of management,
- definitive documentation (which may include substantive agreements with persons other than the company with which 3M has entered into the letter of intent), and
- various regulatory and commercial third party approvals.

It is for this reason that virtually all letters of intent entered into by 3M (including the letter that was sent to AiT) expressly provide that:

- the letter is non-binding (other than in respect of certain provisions that dictate the process through which the parties will continue to endeavour to move towards definitive documentation),
- the party to whom 3M has addressed the letter should not make business decisions in reliance upon the letter or the successful completion of the transaction contemplated by the letter, and
- if negotiations cease or the transaction otherwise does not proceed, neither 3M nor the party to whom the letter is addressed will have liabilities or obligations to the other (except in respect of such things as maintaining the confidentiality of certain information and not soliciting customers or employees).

In this context, 3M generally would not contemplate public disclosure of the delivery of a letter of intent, and in fact, our letters of intent generally contemplate that the existence of the letter will be maintained in confidence and generally no announcement of the transaction contemplated by the letter will be made.

On April 26, 2002, a 3M business team and representatives of AiT had identified a price on which those individuals believed a transaction could be pursued if a number of substantive hurdles could be cleared. However, before definitive documentation could be executed by 3M and before legal obligations in respect of the transaction would be assumed by 3M:

- 3M would have to complete substantive due diligence, including a review of AiT's business operations, research and development, manufacturing, financial, legal, environmental and regulatory matters,
- definitive documentation would have to be drafted and negotiated between 3M and AiT containing substantive representations, warranties and covenants,
- voting and stock options agreements would have to be drafted and negotiated with nine individuals and an unidentified shareholder, and
- the appropriate management committees and the board of directors of 3M would have to approve the acquisition and the plan for the integration of the acquired business.

At the time that the letter of intent was signed, 3M had not yet even retained Canadian counsel.

> In the week following our engagement of Canadian counsel, progress was made on the completion of due diligence and, on May 14, 2002, the 3M board approved the acquisition of AiT:
>
> > subject to the approval of the Chairman of the Board and Chief Executive Officer of the due diligence report and the integration plan.
>
> The completion of that report and the development of those plans, which are substantive and fundamental elements of our acquisition process were not completed until May 21, 2002, when the Chairman and CEO of 3M gave his approval following the meeting of the Corporate Operations Committee held on that date to consider the matter. Similarly, the negotiation of the substantive elements of the transaction documents (including the merger agreement between 3M and AiT, the voting and stock option agreements and employment agreements with key employees) was ongoing, drafts of those documents continued to be circulated and negotiated until virtually the time of their execution.
>
> Put simply, until these steps were completed, there was no deal.
>
> (*Affidavit of Kim Price*, sworn September 21, 2007 at para. 5)

176 Price attached as exhibits materials supporting the process used by 3M to assess and approve the transaction with AiT. These included presentation materials to the 3M board; the resolution passed by the Board on May 14, 2002; meeting minutes of the legal team on May 20, 2002, and a report prepared for the Operations Management Committee on May 21, 2002.

C. The Expert Evidence

1. Anisman

177 Anisman was called by Staff as an expert witness and was asked to provide an opinion about the analytical process to be followed in making an assessment of when disclosure should be made under section 75 of the Act.

178 Anisman's Expert Report, dated August 31, 2007, stated that his evidence was three-fold:

i. to provide a description of the policy underlying section 75 of the Act;

ii. to provide an opinion on the analytical process to be followed in making an assessment as to when disclosure should (or presumably should not) be made under section 75 of the Act; and

iii. to illustrate the analytical process that ought to have been used on the basis of the factual materials provided to him by Staff in this case.

179 Counsel for Weinstein objected to Anisman's evidence on the basis that the report resembled closing argument instead of an expert report. In particular, counsel for Weinstein submitted that it appeared that Anisman's evidence interpreted the facts and applied the law, which is the jurisdiction of the Panel. Coun-

sel for Weinstein and Staff made submissions on this issue and referred us to the relevant case-law.

180 The role of an expert witness is to provide the court or tribunal with special knowledge or expertise beyond the knowledge or expertise of the court or tribunal. It is not the role of an expert to express an opinion on domestic law or the ultimate issues before the Court or tribunal. With respect to Anisman's expert evidence we concluded that points (i) and (iii) set out above, related to the description and interpretation of domestic law, and were thus inappropriate topics to be dealt with in expert evidence. As a result, we restricted Anisman's expert evidence to point (ii) to provide an opinion on the analytical process to be followed in making an assessment as to when disclosure should (or should not) be made under section 75 of the Act. We note that Weinstein also led expert evidence in response.

181 With respect to the analytical process to be followed in making an assessment when disclosure should be made under section 75 of the Act, Anisman testified that the overall approach was to be fact-based, contextual and purposive, and three basic questions were to be asked. The first two questions address whether there is a "material change": first, whether the information or event in question is "material"; second, whether a "change" has occurred. If it is concluded that there is a material change, the third question is whether disclosure should be made publicly, or whether there is sufficient reason to disclose to the Commission confidentially.

182 Anisman suggested that the acquisition of a small issuer by a large issuer would have a sufficiently significant impact on the smaller issuer to cross the materiality threshold, and most of his testimony focused on approaching the second question of when it becomes a "change".

183 Anisman emphasized that the timely disclosure obligation in the Act is inconsistent with a bright-line test. Instead, the determination is factual and must be made in the circumstances of each transaction.

184 The core of Anisman's testimony was the concept of commitment by the parties. The relevant test is to determine when in the course of a negotiation can it be said that there is sufficient commitment by the relevant parties to go forward with the transaction that "constitutes an alteration of the issuer's business or affairs in the circumstances." In his view, it is at this point that a material change occurs and the disclosure obligation is triggered.

185 In the course of negotiating a single transaction, Anisman testified that there may be more than one material change. For example, it is possible that there is a change where there is agreement to the material terms of a transaction, even if negotiations continue with respect to other significant issues.

186 Anisman testified that matters such as board resolutions, agreements in principle, and letters of intent may represent a sufficient degree of commitment to constitute a material change. Accordingly, one or more material changes may

occur well before the signing of a definitive agreement that contains all the terms of the transaction. This determination must be made in the specific context of the transaction, with an objective view of all the information available at the time. In his expert report, Anisman stated:

> The factors that are relevant to determining whether an agreement in principle, for example, is a material change will depend on the nature of the decision it represents, the conditions to which it is subject, how central they are to achieving a transaction and the likelihood that they will, or will not, be satisfied. These factors may be assessed in light of the nature of the negotiations relating to them prior and subsequent to reaching an agreement in principle. In other words, it might be reasonable to ask whether any "deal-breakers" remain outstanding. Of particular significance are resolutions adopted by a board of directors, the terms of any such resolutions, and the desire of the parties to achieve the transaction in question. (Philip Anisman, *Expert Report prepared for Re AiT Advanced Information Technologies Corporation, et al.*, dated August 31, 2007, p. 15)

187 Upon cross-examination, Anisman agreed that with respect to a letter of intent, the terms of the letter of intent would be part of the analysis, and the more binding the terms that start to flesh out an agreement between the parties, the more likely the issuer may have a change.

188 Where the outstanding conditions are in the control of a third party, Anisman testified that the issuer would still have to make an assessment of the likelihood of the conditions being fulfilled, even if the issuer itself doesn't have the ability to fulfill them. This assessment would similarly flow from the entire negotiation and relevant circumstances up to that point. For example, the issuer's understanding that the acquirer was willing to complete the transaction, or was committed to it, would be an important consideration.

189 Anisman testified that once the issuer determines that there is a material change, it must consider whether public disclosure would cause undue harm to the issuer, in which case confidential disclosure might be appropriate. In making this assessment, Anisman stated that it is again a factual determination, taking into account the nature of the detriment, the degree of harm and impact it would have on the issuer, and whether it warrants filing a confidential report with the Commission.

190 According to Anisman, the purpose of confidential disclosure is to alert the Commission that there has been a change so that the market could be monitored for leakage and potential insider trading. He testified that the permissibility of confidential filing serves as a compromise between protecting investors and causing prejudice to issuers.

2. Dey

191 Peter Dey ("Dey") was the expert witness called by the Respondent. He was asked to comment on the types of issues and approach that a board of directors

would be expected to take with respect to disclosure of a material change in the context of a merger and acquisition negotiation.

192 The core of Dey's testimony was the concept that in a negotiated transaction, the board of an issuer must determine if there is a reasonable prospect that the transaction could be completed. In his opinion, a material change occurs when the understanding between the parties is such that there is a reasonable prospect that the transaction could be completed. Otherwise disclosure could be premature, such as where an issuer has no reasonable assurances that the transaction will be completed. This judgment has to be made in the context of the transaction, which is defined by the surrounding facts and circumstances.

193 Dey also explained that a board cannot wait until the completion of the transaction is guaranteed before making disclosure. Often, there will be outstanding conditions at the time disclosure is made. With respect to the outstanding conditions, the test to be applied by the board is whether there is a reasonable prospect that the outstanding conditions will be satisfied. Even when the outstanding conditions are not within the issuer's control, the same analysis must be undertaken.

194 As an example, Dey considered a condition where a transaction could not be completed without approval of the board of the acquirer. In assessing this condition, the board of the acquiree must consider the indications of the other party, such as communications from the acquirer that they were recommending the transaction to the board, who they believed would approve the transaction. In such a situation, this would probably be a condition that had a reasonable prospect of being fulfilled, therefore triggering disclosure. On the other hand, if management of the acquiree indicated that they had no sense whether the acquirer's corporate approvals would be forthcoming, the acquiree would probably resist disclosure.

195 With respect to confidential disclosure, Dey's opinion was that it is very rare and that it is something that is best to avoid. He testified that there would have to be compelling reasons for the company not to make public disclosure at the time that a material change occurred.

IV. The Statutory Regime

196 It is important to note that the Statement of Allegations deals with breaches of the Act that took place in 2002; thus the provisions in the 2002 version of the Act apply in this decision. These provisions are set out in "Schedule A" of our Reasons and Decision. In addition, *National Policy 40 — Timely Disclosure* is set out in "Schedule B" for reference, although it does not form the basis of the allegations against Weinstein in this case.

V. Analysis of the Legal Issues and Evidence

A. The Standard of Proof

197 The standard of proof applicable in Commission proceedings is the civil standard of the balance of probabilities and we find that it remains the applicable standard in this case. We do however acknowledge that the allegations in this case are serious and relate to Weinstein's professional career and livelihood. As a result, we are of the view that this burden can only be discharged by clear and cogent evidence. As stated in *Lett, Re* (2004), 27 O.S.C.B. 3215 (Ont. Securities Comm.) at paragraph 31:

> Requiring proof that is "clear and convincing and based upon cogent evidence" has been accepted as necessary in order to make findings involving discipline *or affecting one's ability to earn a livelihood.*
>
> [emphasis added]

198 Further, we note Staff's submission that although section 122 of the Act is a quasi-criminal offence section, it can be referenced in a section 127 proceeding as long as it does not seek a punitive power beyond the scope of section 127. As stated in *Wilder v. Ontario (Securities Commission)*, [2001] O.J. No. 1017 (Ont. C.A.), at para. 24:

> The Act provides for various remedial routes which themselves entail varying procedural consequences. The reduction in procedural rights under s. 127 from those available in a prosecution under s. 122 results from the simple fact that there is no criminal sanction attached to a s. 127 order. The essence of the statutory scheme is remedial flexibility, not remedial exclusivity, and differing procedural consequences are an inevitable result of such a scheme.

B. The Importance of Timely Disclosure

199 Section 1.1 of the Act sets out two important purposes: (1) to provide protection to investors from unfair, improper or fraudulent practices; and (2) to foster fair and efficient capital markets and confidence in capital markets. One of the primary means of fulfilling these statutory purposes is by enforcing requirements for timely, accurate and efficient disclosure of information. This is because, through timely disclosure, fairness can be achieved for all investors participating in the capital markets. Disclosure serves to level the playing field such that all investors have access to the same information upon which to make investment decisions. As stated by the Commission in *Philip Services Corp., Re* (2006), 29 O.S.C.B. 3941 (Ont. Securities Comm.):

> Disclosure is the cornerstone principle of securities regulation. All persons investing in securities should have equal access to information that may affect their investment decisions. (*Philip Services Corp., Re*, supra at para. 7)

200 Further, disclosure benefits the capital markets because:

> Disclosure in securities markets encourages investing and therefore growth. Disclosure protects investors, aids in ensuring that securities markets operate

> in a free and open manner and ensures that a security will nearly correspond to its actual value. (*YBM Magnex International Inc., Re* (2003), 26 O.S.C.B. 5285 (Ont. Securities Comm.) at para. 89)

201 National Policy 40, which was in force during the Relevant Period, contemplated a broader disclosure regime than the continuous disclosure provisions of the Act. Although it did not have the force of law, it recommended a continuous disclosure system for market participants based upon "material information". Material information refers to "any information relating to the business and affairs of an issuer that results in or would reasonably be expected to result in a significant change in the market price or value of any of the issuer's securities." As such, the Policy differs from the Act by requiring timely disclosure of both material facts and material changes.

202 The Policy also contained a caution to issuers concerning premature and misleading disclosure announcements. As set out in the Policy:

> While all material information must be released immediately, the timing of an announcement of material information must be handled carefully, since either premature or late disclosure may damage the reputation of the securities market. Misleading disclosure activity designed to influence the price of a security is improper. Misleading news releases send signals to the investment community which are not justified by an objective examination of the facts, and may detract from the issuer's credibility. Announcements of an intention to proceed with a transaction or activity should not be made unless the issuer has the ability to carry out the intent (although proceeding may be subject to contingencies) and a decision has been made to proceed with the transaction or activity by the issuer's board of directors, or by senior management with the expectation of concurrence from the board of directors.

203 Staff also addressed confidential disclosure in their submissions and argued that the option of confidential disclosure was available to AiT. Subsection 75(3) of the Act provides for confidential disclosure of material changes where in the opinion of the reporting issuer, public disclosure would be unduly detrimental to the reporting issuer. In Anisman's expert testimony, he stated that confidential filing acknowledges the harm that premature public disclosure could cause to the issuer. He testified that the purpose of confidential disclosure is to alert the Commission to the fact that there has been a change and provides the Commission the opportunity to monitor the market for leakage and potential insider trading. In his view therefore, it serves as a compromise function in the statutory scheme that is designed to both accomplish some protection of investors and not prejudice issuers. We note however, that the issue of confidential disclosure arises in this case only if we determine that a material change has occurred.

C. The Concept of Materiality

204 In any interpretation of material fact or material change, it is first necessary to review and understand the concept of "materiality" in our disclosure regime:

> The test for materiality in the Act is objective and is one of market impact. An investor wants to know facts that would reasonably be expected to significantly affect the market price or value of securities. (*YBM Magnex International Inc., Re, supra* at para. 91)

205 The British Columbia Securities Commission has addressed the issue of materiality in the context of negotiations leading up to a transaction (although in the context of a broader "material information" regime). The following principles were articulated in *Siddiqi, Re* [2005 CarswellBC 3590 (B.C. Securities Comm.)] 2005 LNBCSC 375 at paragraph 87:

> Whether information is material depends on the facts of each case. The test is the expected impact the information would have on the market price or value of the issuer's securities. Where transactions are involved, it is not enough to consider only the materiality of the transaction itself, but also the materiality of the information that negotiations are underway that could lead to a possible transaction. In some cases, the existence of negotiations would or could reasonably be expected to affect the stock price, and is therefore material. (Of course, the existence of negotiations about a proposed transaction can be material only if the underlying transaction itself, if completed, would be material.)

206 Staff also referred us to the applicable test used in the United States, the probability/magnitude test. Staff referred us to the cases: *Securities & Exchange Commission v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (U.S. 2nd Cir. N.Y. 1968) aff'd 446 F.2d 1301 (U.S. C.A. 2nd Cir. 1971); *TSC Industries Inc. v. Northway Inc.*, 426 U.S. 438 (U.S. Ill. 1976); and *Basic Inc. v. Levinson*, 485 U.S. 224 (U.S. Ohio 1988). In particular, Staff points out that the probability/magnitude test has been applied in the context of merger and acquisition transactions in the United States.

207 However, we note that the law in the United States does not include the concept of a "material change" as defined in our Act. The probability/magnitude test was formulated as an appropriate test for determining the materiality of speculative or contingent information. Although the American probability/magnitude test may be useful with respect to materiality, it is not particularly useful in determining whether a change has occurred, which is crucial in this case. As a result, we are wary of quoting and adhering to the American case law, especially when the American law does not incorporate the concept of a "material change" as the Ontario statute does.

208 In the present case, the negotiations between AiT and 3M were material in relation to AiT as a reporting issuer: negotiations of a potential acquisition transaction by 3M could reasonably be expected to affect the market price or value of AiT's shares and were therefore material. AiT was also a small company rela-

tive to 3M, and materiality often occurs at a much earlier stage for smaller issuers than larger issuers.

D. The Distinction Between a Material Fact and a Material Change

209 Having determined that the negotiations between AiT and 3M were material to AiT, it is necessary to determine whether those negotiations represented a "material fact" or a "material change". The definition of a material fact is much broader than that of a material change. As set out in subsection 1(1):

> "material fact", where used in relation to securities issued or proposed to be issued, means *a fact* that significantly affects, or would reasonably be expected to have a significant effect on, the market price or value of such securities [emphasis added].

On the other hand, a material change is defined as:

> "material change", where used in relation to the affairs of an issuer, means *a change in the business, operations or capital of the issuer* that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer and includes a decision to implement such a change made by the board of directors for the issuer or by senior management of the issuer who believe that confirmation of the decision by the board of directors is probable
>
> [emphasis added].

210 Not all material facts will be significant enough to constitute a change in the business, operations or capital of the issuer, and therefore be a material change. The Act makes an important distinction between the definitions of a material fact and a material change in subsection 1(1). This distinction is fundamental to the various requirements under the Act since certain disclosure requirements are triggered by the occurrence of a material change (but not a material fact). For example, only in the event of a material change does section 75 of the Act require an issuer to issue a news release and also file with the Commission a material change report on a timely basis, or alternatively file a confidential material change report with the Commission. In contrast, section 76 of the Act does not require disclosure of either material changes or material facts, but prohibits anyone from purchasing or selling securities with knowledge of a material fact or material change that has not been generally disclosed to the public.

211 As Anisman explains in his expert report, the distinction between "material facts" and "material changes" in the legislation recognizes the need of issuers to keep certain developing transactions confidential in the course of negotiations. For example, in a negotiation for a merger transaction, such negotiations may be material at a very early stage and for the purpose of insider trading laws, persons aware of such "material facts" should be prohibited from trading on this information. However, this may be well before the negotiations have reached a point of commitment to be characterized as a change in the issuer's business, opera-

tions or capital, and therefore, before public disclosure of the information would be appropriate.

212 The legislature specifically chose to distinguish material changes from material facts and to create different disclosure requirements for them. This was emphasized in *Kerr v. Danier Leather Inc.*, [2005] O.J. No. 5388 (Ont. C.A.) ["*Danier CA*"]:

> [...] the OSA has preserved the distinction. Thus we must assume that the Legislature intended the distinction to yield different disclosure obligations. In the Court of Appeal decision in *Pezim v. British Columbia (Superintendent of Brokers)* (1992), 96 D.L.R. (4th) 137 (B.C. C.A.), at 150, Lambert J.A. made this point in discussing the same distinction under the British Columbia statute:
>
> > There is a legislative reason for distinguishing between material facts and material changes and it is no accident that the legislature did not impose an obligation under s. 67 [of the B.C. Act] to disclose material information unless that information amounted to a change in the business, operations, assets or ownership of a reporting issuer. In enacting s. 67 in its present form the legislature must be taken to have rejected the more exacting standard that would have been imposed if "material facts" (or "material information" as it is described in national policy No. 40) were included in that section.
>
> Although the Supreme Court of Canada overturned the decision of the British Columbia Court of Appeal, it did not quarrel with Lambert J.A.'s conclusion on the legislative distinction between material facts and material changes: see *Pezim v. British Columbia (Superintendent of Brokers)*, [1994] 2 S.C.R. 557 (S.C.C.). (*Danier CA*, *supra* at para. 105)

213 The legislation clearly differentiates between material changes and material facts, setting up different disclosure obligations and restrictions for each. It clearly contemplated that issuers might be aware of a material fact and insiders must be prevented from trading with such knowledge (section 76 of the Act). However, the existence of a material fact alone does not give rise to the disclosure obligation under section 75 of the Act.

E. The Assessment of a Material Change is Not a Bright-Line Test

214 Staff in its submissions placed great emphasis on the addition of the words "a decision to implement such a change made by the board of directors of the issuer" to support the proposition that a material change can occur in advance of the execution of a definitive binding agreement and therefore the determination of whether a material change has occurred is not a "bright-line" test.

215 We agree that there is no "bright-line test". Instead, the assessment of whether a material change has taken place will depend on the circumstances and series of events that took place. This is because the determination of a material

reason to believe that the other party is also committed to completing the transaction, as discussed below.

220 Staff also referred us to *Bennett, Re* [[1996] 34 B.C.S.C.W.S. 55 (B.C. Securities Comm.)] 1996 LNBCSC 38, rev'd in part [1998] B.C.J. No. 2378 (B.C. C.A.), leave to S.C.C. refused (1999), [1998] S.C.C.A. No. 601 (S.C.C.). Staff takes the position that this case stands for the proposition that a decision to sell a control block of shares is a material change even though there was no agreement and no purchaser had been identified. The British Columbia Securities Commission noted that since legal and financial advisors had been retained for a possible transaction and serious discussions had taken place, this constituted a material change.

221 The present case can be distinguished from the British Columbia Securities Commission case *Bennett, Re*. First, *Bennett, Re* was an insider trading case. Second, Doman was a controlling majority shareholder of Doman Industries:

> Doman controlled Doman Industries. If he decided to sell Doman Industries, Doman Industries would be sold. It would be irrelevant what the directors had to say. The decision to sell Doman Industries was his alone to make. (*Bennett, Re, supra* at 99 and 100)

222 In any event, we find that there is no bright-line test with respect to a material change, and the fact that legal and financial advisors are retained will not on its own be sufficient to demonstrate that a material change has occurred. Therefore, the fact that legal and financial advisors are retained is not determinative of the existence of a material change.

223 However, in our view, in the context of a proposed merger and acquisition transaction, where the proposed transaction is speculative, contingent and surrounded by uncertainties, a commitment from one party to proceed will not be sufficient to constitute a material change. In the context of a merger and acquisition transaction, it is necessary to establish whether there is sufficient commitment from both parties of the transaction to determine whether a "decision to implement" the transaction has taken place. Therefore, in the case at bar, we need to establish whether a sufficient indication of commitment was made by AiT and 3M during the Relevant Period.

224 We rely on Anisman's wording "when a decision has been made indicating a substantial likelihood that implementation will be forthcoming". In our view, for there to be a substantial likelihood that a proposed transaction will be completed, there needs to be sufficient signs of commitment on behalf of all the parties involved to proceed with the transaction.

225 In the present case, the determination of whether a material change occurred requires ascertaining whether the series of events that took place during the Relevant Period constitute a material change. As a result, this requires an in depth analysis of the facts in this case.

change is a question of mixed fact and law (*YBM Magnex International Inc., Re, supra* at para. 94). This determination requires ascertaining whether the existing facts fulfill the legal test. Each case will be unique, and the specific facts and circumstances will vary case by case. Since the fact scenarios will differ in all cases, it is impossible to articulate a bright-line test that will apply in all circumstances.

F. Interpretation of "Decision to Implement a Change" by a Board of Directors

216 The definition of a "material change" in the 1978 legislation was the first time a reference to a material change included "a decision to *implement* such a change made by the board of directors of the issuer" [emphasis added]. The word "implement" is not defined in the Act, however, we note that the *Canadian Oxford Dictionary* defines the word "implement" as "to put into effect". (*The Canadian Oxford Dictionary*, 2001, s.v. "implement").

217 Anisman noted in his expert report:

> As a "material change" must be reported when it occurs, the question of what may constitute a change is frequently characterized in terms of when a change occurs, particularly in the context of negotiated transactions involving mergers and acquisitions. Such negotiations may move from overtures, through tentative discussions, into exclusive or non-exclusive arrangements involving confidentiality agreements, to letters of intent and agreements in principle, preparation of a definitive agreement, submission to shareholders for approval, fulfillment of conditions, and ultimately to closing and implementation. Any or all of these steps may be material, as outlined above. *A change will occur when a decision has been made indicating a substantial likelihood that implementation will be forthcoming.*
>
> [emphasis added] (Philip Anisman, *Expert Report prepared for Re AiT Advanced Information Technologies Corporation, et al.*, dated August 31, 2007, p. 12)

218 While the Act is silent regarding the definition of "implement" we note that the Commission has addressed this issue in *Burnett, Re* (1983), 6 O.S.C.B. 2751 (Ont. Securities Comm.). The Commission stated that:

> An intention by a person or company to do something, which once implemented would constitute a material change in the affairs of the reporting issuer, but which at the time the intention is formed, *for reasons beyond the control of the person or company is still not capable of achievement is not ordinarily a material change* in the affairs of the issuer.
>
> [emphasis added] (*Burnett, Re, supra* at para. 7)

219 A decision by a board of directors of an issuer to pursue a potential transaction that is not yet within its control to put into effect (and therefore is not then capable of achievement), would not ordinarily be a material change in the business, operations or capital of an issuer at that point in time unless the board has

G. Application of the Evidence and Law

1. Did the status of negotiations with 3M constitute a "material change" in the business, operations or capital of AiT by April 25, 2002 and during the subsequent period up to May 9, 2002, in which case triggering the requirements under s. 75 of the Act?

i. Summary of Staff's Allegations

226 Staff allege that a material change in the business, operations or capital of AiT occurred during the Relevant Period as a result of: the AiT Board meeting of April 25, 2002, the negotiation and signing of the LOI on April 26, 2002, the ongoing discussions between 3M and AiT, and the completion of the on-site due diligence review undertaken by 3M on May 7 to May 9, 2002. Accordingly, Staff allege that AiT breached section 75 of the Act by failing to make timely disclosure of the material change within the Relevant Period.

227 We have identified three key events during the Relevant Period which must be analyzed to determine whether those events alone, or in combination, represented a material change to AiT as alleged:

a) the events leading up to April 25, 2002, and the AiT Board meeting of April 25, 2002;

b) the LOI signed by AiT and 3M on April 26, 2002; and

c) the balance of the Relevant Period, including the second due diligence review undertaken by 3M from May 7 to May 9, 2002.

We have analyzed the evidence and the arguments of Staff surrounding each of these events below.

228 In view of the Supreme Court's decision in *Kerr v. Danier Leather Inc.*, 2007 SCC 44 (S.C.C.), we cannot defer to the business judgment of the AiT Board to determine when or if a material change occurred. Instead, we must objectively assess the facts that were available to the AiT Board during the Relevant Period, to determine in all the circumstances whether the three events constituted a material change in the business, operations or capital of AiT that triggered its disclosure obligation under section 75. It is important therefore, to recognize the dangers of hindsight in coming to this conclusion and to be careful not to look at the situation based on what subsequently happened. Staff referred us to the following passage from *The Regulation of Corporation Disclosure*:

> First, negotiations can only be material if the resulting agreement is material. Second, the ultimate outcome of the negotiations has no direct bearing on the analysis. *The materiality of ongoing negotiations turns upon the facts known at the time the duty to disclose was triggered, with subsequent developments not affecting the outcome.*
>
> [Emphasis added] (Robert Brown, *The Regulation of Corporation Disclosure*, looseleaf ed. (Wolters Kluwer, 2007) at 6-13.)

229 Therefore, we must assess the information as it existed during the Relevant Period to determine whether a material change occurred.

ii. The Events Leading up to, and the April 25, 2002 AiT Board Meeting

230 The first discussions with Harrold in February 2002, through the signing of a non-disclosure agreement, the first due diligence session, the pricing discussions in St. Paul and the April 23 and 24, 2002 telephone calls from 3M to Ashe constituted the early stages of negotiation towards a potential share purchase transaction that collectively constituted a material fact in relation to AiT within the definition of that term in the Act. However, considering that the negotiation was still in its early stages, we do not find that any of these events individually, or all of them collectively, constituted a material change for AiT.

231 On April 25, 2002, an AiT Board meeting was called by Ashe to report on the culmination of the early negotiations with 3M which had resulted in 3M advising Ashe that they were prepared to offer $2.88/share for the outstanding shares (and in-the-money options) of AiT. 3M had requested Ashe to obtain the support of the AiT Board to the proposed price because they were not interested in expending additional time and effort to conduct further due diligence and evaluate whether they wanted to enter into a transaction without this support. At this point in time, AiT had received nothing in writing from 3M relating to the proposed offer of $2.88/share.

232 The minutes of the AiT Board meeting on April 25, 2002 confirm that Ashe provided the AiT Board with an update of the discussions with 3M and communicated the verbal offer of $2.88/share of AiT. It is also clear from the minutes that the AiT Board was informed that subject to their approval, 3M would draft a non-binding LOI to continue the process, which included the due diligence, the negotiations of the definitive agreement and the requisite approvals required to culminate the potential transaction.

233 As of the date of the April 25, 2002 meeting, there had been no actual change in the business, operations or capital of AiT, but Staff rely on the reference in the material change definition to "a decision of the board to implement such a change" as being a material change in itself, without the need for there to be an actual change in the issuer's business, operations or capital.

234 Staff draw support for their position from the wording of the minutes of the AiT Board meeting on April 25, 2002: "the board approved the recommendation to shareholders of the acquisition by 3M of all of the outstanding shares and options in the Company at a cash purchase price of Cdn $2.88, subject to confirmation of the fairness of this price by the Company's financial adviser, CIBC Investment Banking, and satisfaction of the Board with the final terms of the transaction, including the tax consequences to the Company's shareholders". In the view of Staff, the AiT Board was clearly signing off on the transaction and providing their unqualified support, subject to conditions favourable to AiT,

which constituted a "decision to implement such a change" within the material change definition language.

235 We disagree with Staff's interpretation of the AiT Board resolution based on the evidence presented during the hearing as to the purpose of the meeting, the discussions held by the AiT Board at that meeting on the status of the transaction, and the timing and preparation of the actual minutes of the meeting:

- The purpose of the meeting, as requested by 3M in their timetable for the negotiation and settlement of the transaction, was to obtain the support of the AiT Board for the level of value 3M was proposing to offer for the shares of AiT. The evidence indicates that the board discussions that took place that day are not accurately reflected in the wording of the minutes or in the resolution itself. For example, Damp recollected that the discussion on April 25, 2002 regarded 3M's request for agreement from significant shareholders that they would be open to accepting a transaction at the proposed price. Weinstein further confirmed this and testified that she understood the AiT Board's support on April 25, 2002 to be a precursor to 3M proceeding with their in-depth process and the expending of resources to continue the negotiation process.
- As the report from Ashe indicated, the negotiations were at a preliminary stage which was inconsistent with an experienced board of directors signing off on a negotiated transaction in order to "implement" a proposed material change. Due diligence to confirm a $2.88 per share price and other matters had not yet been carried out. Nothing had been received in writing on the proposed transaction and key items important to the transaction (such as the Voting and Stock Option support agreements from key shareholders and the break fee) still had to be negotiated.
- According to Weinstein, if the AiT Board was in fact attempting to implement the transaction at this stage, it would have been necessary for the AiT Board to waive AiT's shareholder rights plan, as the accepted offer would have constituted a triggering event. As evidenced by Weinstein's testimony, she would have recommended to the AiT Board to waive the shareholders' rights plan had she thought that a decision to implement the proposed transaction had been made.
- Although the wording of the AiT Board resolution passed on April 25, 2002 indicated that it was subject to confirmation of the fairness of the price by AiT's financial advisor, CIBC Investment Banking, it appears from the fairness opinion that CIBC Investment Banking was not formally retained as AiT's financial advisor until May 2, 2002.
- Dunleavy's testimony is that the minutes were not prepared until late June and amended in July, just before the closing of the transaction, as a clean-up item. He testified that he used wording for the resolution from

the proxy circular mailed to AiT's shareholders for consistency. Dunleavy was not present at the AiT Board meeting on April 25, 2002.

236 We find that the AiT Board minutes of the April 25, 2002 meeting are problematic, and we do not believe that the AiT Board resolution conveys the substance of the decision made by the AiT Board. The evidence shows that these minutes were initially drafted in late June 2002 and then amended in early July 2002 to conform with disclosure that had been included in the proxy circular. Based on the stage of negotiations with 3M at April 25, 2002 and the evidence presented to us, we believe the better depiction of the AiT Board's decision is described in CIBC Investment Banking's Summary Chronology of Events included in its May 22, 2002 presentation of its fairness opinion:

- Following various negotiation discussions (including matters such as financial forecast, tax losses carry forward and tax credits pool), Tenor [3M] agrees to raise the valuation of Amigo [AiT] common shares to $2.88 per share (approximately $42.6 million).
- Bernie Ashe meets Amigo's [AiT's] Board of Directors to discuss the Tenor [3M] opportunity and how it is the best alternative for Amigo [AiT] in light of similar transactions in the industry.
- Amigo's [AiT's] Board of Directors communicates to Bernie Ashe that a Tenor [3M] offer at the proposed level would likely be approved.

We conclude after reviewing the evidence that the minutes of the April 25, 2002 meeting do not accurately reflect the AiT Board's discussions, and that the resolution was not intended by the AiT Board to be a "decision to implement such a change" within the meaning of the definition of material change, as alleged by Staff.

237 By contrast, the resolution of the AiT Board on May 22, 2002, after reviewing the Merger Agreement, the Fairness Opinion and other relevant information, did represent a "decision to implement such a change" and the resolution specified that the transaction was fair and in the best interests of AiT and its shareholders. In addition, at this time on May 22, 2002, the AiT Board waived the shareholder rights plan with respect to the Merger Transaction.

238 In arriving at the conclusion that there was no material change on April 25, 2002, we were mindful of the more than 5 year timeframe which had elapsed between the events giving rise to the allegations, and the completion of the hearing. That timeframe posed difficulties in obtaining accurate recollections of the events from witnesses, reconstructing the factual information available to the AiT Board and Weinstein at that time and determining whether there was clear and cogent evidence necessary to support Staff's allegations.

239 Our decision process was not helped by concerns we identified in the recording of the minutes of the April 25, 2002 AiT Board meeting. Dey testified that if a board's governance process, in the view of the Commission, is effective, then

it is difficult for anyone to interfere with the judgments that are the product of that process. We agree with that proposition, while being mindful of the recent Supreme Court decision in *Danier*, which opined that the disclosure requirements under the Act are not to be subordinated to the exercise of business judgment.

240 In determining whether the governance system within which a board functions is effective, Dey suggested one would look for a board with an appropriate set of competencies, a board that is motivated to do the right thing for the corporation and a board that receives effective advice from management and external legal advisors.

241 In the case of the AiT Board, we believe that it was very experienced and properly motivated. There was no evidence presented to suggest a lack of independence or any conflicts of interest existed with respect to the 3M transaction. We do note that Weinstein acted as both a director of AiT and as legal counsel to the AiT Board and AiT, which would not be an appropriate corporate governance practice today. However, there is no evidence that she was biased by her role and engagement as a service provider to AiT. The difficulty in judging the AiT Board's governance process is the quality of the written record as to the advice sought by and received by the AiT Board and as to the decision made by the AiT Board at its April 25, 2002 teleconference meeting.

242 We have a concern that the AiT Board may have been unduly influenced in its assessment of the requirement to disclose its decision by concerns relating to the potential negative implications of public disclosure. We must rely on the uncontested affidavits of Lumley and Macmillan and the testimony of Damp, Ashe and Weinstein to assess what the AiT Board's view of the potential transaction with 3M was at the April 25, 2002 meeting. It is clear that the AiT Board believed there were many risks and uncertainties to getting a deal done with 3M at the indicated valuation of $2.88 per share. Most of these concerns related to business matters that could emerge through the detailed due diligence process, as well as the possibility that 3M could ultimately decide not to proceed with an offer for its own reasons not related to AiT.

243 The AiT Board also had concerns that the disclosure of the negotiations with 3M could result in 3M not proceeding further with the transaction and/or cause negative reactions from AiT competitors. What is not clear, more than 5 years after that meeting on April 25, 2002, is the degree to which these concerns influenced the AiT Board's collective judgment that there was no material change resulting from their decision at that meeting.

244 There is no written record of the legal advice the AiT Board requested and received from Weinstein at that meeting regarding AiT's disclosure obligations. The evidence does show that the requirement to disclose the negotiations with 3M was raised by an AiT Board member (Lumley) and discussed by the AiT Board. However, there is no written record of this discussion to assist us in un-

derstanding how the AiT Board addressed this issue. We are left with an impression that the AiT Board generally was not advised that a confidential filing with securities regulators, rather than a public press release, was an option available to AiT if the AiT Board had determined that there had been a material change resulting from their decision at the April 25, 2002 meeting, and that public disclosure of the material change would be unduly detrimental to AiT at that time.

245 Although we have some concerns about the quality of the AiT Board's minutes of its April 25, 2002 meeting, it was not alleged that there was bad faith involved in the preparation of the minutes. We believe AiT benefitted from the AiT Board's collective experience, motivations and level of engagement through its special committee process that were all brought to bear in its decision making and, by extension, to the judgments that flowed from the AiT Board's governance process.

iii. The April 26th Non-Binding LOI

246 Our review of the importance of the LOI in the material change analysis is undertaken in the context of an arm's length negotiated third party transaction, and specifically this factual situation in which a small public issuer acquiree with substantial motivation to sell its business is in protracted negotiations with a large, multi-national acquirer which has disclosed to the issuer a detailed review and authorization process (Six Sigma) which it must follow in order to complete such an acquisition.

247 Staff's position, Anisman's expert testimony and Weinstein's testimony support the view that a signed, definitive agreement is not a prerequisite to finding a material change in a merger transaction. As noted above, there is no "bright line" test by which to determine whether a material change has occurred in such a negotiated transaction; rather the determination must be made on the specific facts surrounding each negotiation, including the nature of the parties to the negotiations, their specific circumstances, the progress of the negotiations toward agreement on all major terms, outstanding conditions or contingencies, and all other relevant factors.

248 We agree that, in appropriate circumstances, a material change can occur with respect to an issuer in advance of the execution of a definitive agreement, requiring that issuer to comply with the timely disclosure obligations imposed by section 75 of the Act. That determination will depend entirely on the facts of each case and the progress and uncertainties facing the parties during the negotiation process.

249 In assessing whether a LOI or an agreement in principle constitutes a material change, Anisman suggests looking at the nature of the commitment that they represent, the substance of what has been agreed to in principle, and whether it specifies all of the key terms, even if it leaves out some matters still to be con-

cluded. Also, he states that the more binding the terms that start to flesh out an agreement between the parties, the more likely the issuer may have a change.

250 The nature of any conditions to the transaction is an important factor as well — Anisman suggests looking at the conditions that remain outstanding, how central they are to the transaction in question, the likelihood of their being satisfied (both objectively and in the belief of the parties at the time), and all of those would be factors in weighing whether there was a sufficient commitment from the parties to conclude that there has been a material change to the issuer.

251 Dey testified that a board can't wait until completion of the agreement is guaranteed (for example, when any remaining conditions to closing specified in a definitive agreement have been satisfied). There will be outstanding conditions at the time disclosure is usually made. The board must assess whether there is a reasonable prospect that those conditions will be satisfied so that the transaction can be completed. Disclosure before there is a reasonable prospect of the conditions being satisfied would be premature.

252 Where corporate approval by the acquirer's board and senior management is a condition, both Anisman and Dey suggest it will come down to what the acquiree understands about the acquirer's approval process and its status, and whether the acquiree has an understanding of the likelihood of those approvals being forthcoming, in determining whether disclosure would be premature.

253 The LOI was submitted to AiT on April 26, 2002 and was not acceptable to AiT's legal counsel without further negotiation. For example, AiT negotiated the reduction of the exclusivity period from 120 days to 30 days, the addition of a provision allowing AiT to back out if a superior proposal came along at an agreed to amount, and modified the requirement regarding support agreements.

254 The LOI confirmed the parties "mutual understanding" of the negotiations to that point in time for a proposal by 3M to purchase all of the outstanding shares of AiT:

- [Para. 1] 3M was prepared to offer $2.88/share "based on the data furnished by AiT" and not previously validated by 3M, and AiT was required to maintain similar balance sheet conditions and levels shown in AiT's most recent quarterly regulatory filing, up to the time of closing;
- [Para. 3] The proposal to purchase the shares and the price to be paid, was subject to a favourable due diligence review by 3M covering AiT's business operations, research and development, manufacturing, financial, legal, environmental and regulatory matters, as well as negotiation of a definitive purchase agreement containing usual representations, warranties and covenants;
- [Para. 4] The LOI refers to "3M's continued evaluation of a potential transaction with AiT, and as an inducement for 3M to continue to expend time and incur expenses" 3M required a "no shop" restriction from AiT.

At that time, 3M had not made a commitment to proceed and there was more work to be accomplished on 3M's side with respect to the evaluation of a potential transaction with AiT;

- [Para. 6] 3M's obligation to complete the transaction was also conditional on certain key shareholders entering into voting and stock option agreements and the "indication of value" and LOI was expressly stated to be non-binding and subject to the approval of the appropriate management committees and board of directors of 3M and termination or waiver of any AiT shareholders' rights plan. The letter added "Accordingly, you should not make any business decisions in reliance upon this letter or the successful consummation of the proposed transaction"; and
- The LOI concludes "If the foregoing meets with the approval of AiT, we are prepared to proceed with our due diligence review and other transactions necessary to complete a transaction...", signalling the preliminary nature of the LOI.

255 Staff referred us to *Re Anthian Resources Inc.* 1999 LBBCSC 132, as an authority which supports the position that an LOI triggers disclosure obligations. In our view, disclosure obligations do not automatically arise upon the signing of an LOI under our material change timely disclosure system. We note that in some cases the signing of an LOI may trigger disclosure, and this will depend on the content of the provisions of the LOI and the degree of commitment reached by the parties. In the present case it is clear from the terms of the LOI itself that:

- the LOI was non-binding with respect to the offer to purchase the shares of AiT, and 3M did not intend to assume any legal obligations or infer any commitment in regard to completing a purchase of the shares by signing the LOI;
- the proposed price of $2.88/share was not a firm commitment, and was subject to renegotiation downwards if the due diligence review identified substantive problems or if AiT's financial condition worsened;
- 3M was prepared to continue its evaluation of a potential transaction with AiT in return for a 30 day "no shop" and exclusivity period; and
- most of the conditions of the LOI necessary to be satisfied before 3M would commit to the transaction were beyond the ability of AiT to resolve.

256 In light of these facts, we conclude that entering into the LOI in the present case did not trigger disclosure obligations by AiT. The principal term contained in the LOI (the proposed purchase price of $2.88/share) was based on information supplied by AiT and was not firm, as it was subject to a detailed due diligence review yet to be completed; several key terms contemplated by the LOI (such as the break fee and the Voting and Stock Option Agreements from specified key shareholders) had not yet been negotiated; and, 3M was clearly not

committed to complete the potential transaction. As such, entering into the LOI was not a material change in the business, operations or capital of AiT.

iv. The Degree of Commitment by the Parties

257 Both Anisman and Dey testified that even in the absence of a legally binding agreement, there could be a material change if both parties to the negotiations were clearly committed to completing a transaction.

258 From the testimony of Ashe, Damp, Lumley and Macmillan it is clear that senior management and the AiT Board believed that the proposal from 3M was a fair price and that they would support the completion of a transaction at that value. We have no difficulty concluding that AiT was committed to pursuing the transaction from a very early stage in the negotiations, and that the AiT Board supported the efforts of Ashe to conclude the transaction on the most favourable terms possible, including the proposed price, and in the shortest timeframe possible. We believe the AiT Board meeting of April 25, 2002 authorized Ashe to execute the LOI and to pursue completion of a definitive agreement with 3M as quickly as possible in view of the financial condition of AiT at that time.

259 We are unable to conclude from the evidence that 3M was also committed to the transaction at the LOI stage, or that Ashe or the AiT Board could reasonably conclude at that time that there was a substantial likelihood that the LOI conditions would be satisfied and that the transaction would be completed:

- Ashe, Damp, Lumley and Macmillan were all hopeful that the process identified by 3M would go well and supported completion of the 3M proposal, but all had serious reservations that the due diligence and other stages of the internal approval process of 3M would be favourably determined so that 3M could complete the transaction;
- Determining the prospects of a successful completion of the transaction requires supporting factual evidence of the commitment necessary from 3M and the likelihood that any outstanding conditions would be satisfied, not mere emotional optimism or "hope";
- Ashe and the AiT Board were well aware of how structured the 3M approval process was (the Six Sigma process) and that the primary contact during the negotiations was Harrold, a middle management level manager who did not have the authority to bind 3M to proceed or to waive compliance with the remaining elements of the Six Sigma approval process. In particular, Damp and Weinstein testified that Harrold would have to obtain a series of corporate approvals to get the transaction completed, including approvals from the CEO of 3M and the board of directors. At the time, Damp and Weinstein felt that it was unpredictable how each level of 3M's management would view the transaction;
- With an organization as large and as complex as 3M it is important to distinguish between the business team's enthusiasm for doing a transac-

tion which will enhance their operating unit's size and contribution to the 3M organization's success, and the corporate level approvals which had to be in place before 3M was committed to proceed with the acquisition of the AiT shares. The importance of corporate level approval within 3M is clearly evidenced by the affidavit of Price, which is set out above in paragraph 175 of our Reasons and Decision. In the specific context of the potential transaction with AiT, Price stated that there were a number of substantive hurdles that were required to be cleared as of April 26, 2002. These included the completion of substantive due diligence, the drafting and negotiation of definitive documentation, drafting of voting and stock option agreements, and the approval of management committees and the board of directors of the acquisition and the plan for the integration of the acquired business;

- Price stated that the approval of the 3M board did not occur until the completion of the due diligence, and even then, when the board approved the acquisition on May 14, 2002, it was still subject to the approval of the CEO of the due diligence report and integration plan. Price further stated that the completion of this report and plan was considered a substantive and fundamental element of 3M's acquisition process, and did not actually occur until May, 21, 2002; and
- AiT had an experienced board who were knowledgeable about corporate level approvals and were aware that the 3M negotiation was conducted by a "middle management" team three levels below the CEO. This is not a transaction that was negotiated by the senior management whose approval would be required, and there is no clear and cogent evidence adduced by Staff that Ashe or the AiT Board members had any factual basis by April 26, 2002 to conclude that the essential 3M corporate level approvals were reasonably likely to be obtained, or that there was a substantial likelihood that 3M would complete the transaction. As stated above, all were hopeful of a favourable outcome but all were aware that the conditions were largely beyond the control of AiT. AiT was later informed that the first of these corporate approvals was not made until the 3M board meeting of May 14, 2002, five days after the end of the Relevant Period.

260 Staff also put significant weight in argument on several allegations by which AiT's management and the AiT Board could have concluded that 3M was committed to proceeding by the April 26, 2002 LOI date:

- the proposed acquisition fit within the post-9/11 corporate strategy of 3M as articulated by its CEO;
- Harrold's boss, Swain, and Swain's boss Weber, and the CEO were all aware of the negotiations with AiT;

- the LOI was signed by Weber, an Executive Vice-President of 3M who reported directly to the CEO;
- Harrold had set out a process timetable which was aggressive and 3M seemed to be adhering to it;
- Ashe reported to his banker that the 3M CEO had signed off on the price on April 22, 2002;
- the total value of the AiT transaction in USD was barely over the $25 million threshold level requiring 3M board approval;
- 3M had acted in good faith throughout the negotiations up to the LOI date;
- The fact that AiT was in dire financial circumstances; and
- AiT would not have given exclusivity to 3M on April 26, 2002, if there was not a reasonable prospect of completing a transaction with 3M.

261 With respect, we do not find Staff's arguments compelling:

- although some senior members of 3M's management team were "aware" of the negotiations, it was clearly in the context of a detailed fact-driven and disciplined acquisition process (Six Sigma) designed to ensure that corporate decisions were made prudently based on fundamental data, and not emotional factors;
- the Six Sigma process had many stages that had to be satisfied sequentially in order to obtain the corporate level approvals necessary to result in a binding commitment and the closing of the negotiated transaction;
- a board's governance process is not likely to be more casual or less substantive merely because the transaction value is close to the $25 million threshold limit, and 3M still followed their Six Sigma process notwithstanding the relatively modest purchase price (for 3M); and
- the fact that an Executive Vice-President is signing a clearly non-binding LOI should not be construed as an indication of commitment on the part of 3M to complete a subsequent transaction, particularly when the LOI refers to expending time and money with a view to evaluating a potential transaction, and in the context of the 3M Six Sigma process.

262 As a result, we conclude that the facts available to AiT's management and the AiT Board during the discussion of the 3M proposal and the negotiation and execution of the LOI were not sufficient to override the clear non-binding nature of the proposal and the LOI and would not have led to a conclusion that, at that point in the negotiations, 3M was committed to completing a potential transaction.

263 We agree that in appropriate circumstances (for example, a smaller, less process-driven acquirer; negotiations being led by the acquirer's CEO and within his level of corporate commitment authority; a previous board resolution setting

out preauthorized criteria for acquisition transactions) it might well be appropriate to conclude that a material change has occurred at an agreement in principle or letter of intent stage, and that an issuer acquiree should make timely disclosure of that material change based on a determined level of commitment of the parties to complete the transaction, although no definitive agreement has been negotiated or entered into. In our view, in the context of whether a board decision constitutes a material change, an issuer's disclosure obligations arise not when a potential transaction is identified and discussed with the board, but instead, when the decision by the board to implement the potential transaction is based on its understanding of a sufficient commitment from the parties to proceed and the substantial likelihood that the transaction will be completed.

v. The Balance of the Relevant Period

264 Our review of the evidence, and Staff's argument does not suggest that there were significant developments after the signing of the LOI on April 26, 2002 and the completion of the on-site due diligence review that would have suggested to AiT's management or the AiT Board that 3M was then more committed to completing the proposed transaction than they were at the LOI stage:

- 3M did not respond to Ashe's efforts to move the transaction along by having Dunleavy prepare a pre-acquisition agreement setting out proposed terms for review by 3M;
- Although 3M appointed Canadian legal counsel on May 6, 2002 and discussions between that counsel and Dunleavy resulted in a better understanding of a proposed structure for the transaction on May 8, 2002 (changing from a share purchase transaction to a merger transaction with a Canadian affiliate of 3M), it remained subject to completion of the due diligence review and the other 3M corporate approvals identified in the LOI;
- Although Ashe testified that he was not aware of any "deal breakers" which were outstanding as 3M began its in-depth second stage due diligence review from May 7 to May 9, 2002, he was aware that the process was far more extensive and detailed than he had estimated and recounted to his banker on April 25, 2002 after the AiT Board meeting. The due diligence process did not alleviate all of Ashe's concerns that issues may emerge that could dissuade 3M from proceeding. For example, two issues remaining after the conclusion of the due diligence of May 7, 8 and 9, 2002 which had to be resolved included tax treatment for the option holders and employment issues regarding severance. Ashe was also focussed on "business related" deal breakers and did not address the obvious potential deal breakers such as the failure of Harrold and his team to obtain the required 3M corporate level approvals;

- The May 7 to May 9, 2002 due diligence process was not only extensive, its purpose was to assemble documents and information to be taken back to 3M headquarters for more detailed review and follow-up analysis post-May 9, 2002. Ashe received no indication of 3M's satisfaction with the due diligence review before 3M's due diligence team departed on May 9, 2002 and the first indication that 3M was prepared to proceed to the next stage of their acquisition process was the receipt of the draft Merger Agreement by AiT on or about May 14, 2002. 3M board approval was given on May 14, 2002 subject to further internal 3M committee and CEO approvals to be obtained before the signing of a definitive agreement, but the evidence is unclear as to when Ashe was notified of the 3M board's approval.

265 We conclude that during the balance of the Relevant Period from April 27 to May 9, 2002, no information came to the attention of Ashe or the AiT Board that would reasonably have caused them to believe that 3M was at that time committed to proceeding to complete the transaction.

vi. Conclusion

266 For the reasons set out above, we conclude that with respect to the ongoing negotiations between AiT and 3M up to the April 25, 2002 AiT Board meeting and to the end of the Relevant Period, there is no clear and cogent evidence that any events during that period, either alone or collectively, constituted a material change in the business, operations or capital of AiT. As a result of that determination, AiT was not in breach of section 75 of the Act and was not required to make timely disclosure of its negotiations with 3M for the purchase by 3M of all of the shares of AiT during that time.

267 Having reached the conclusion that AiT did not breach section 75 of the Act, the allegations against Weinstein must be dismissed.

2. If there is a material change, did Weinstein in her capacity as a director of AiT, authorize, acquiesce or permit a breach by AiT of section 75 in contravention of section 122(3) of the Act and contrary to the public interest under section 127(1) of the Act?

268 Having determined that a material change did not occur during the Relevant Period, it is unnecessary for us to address this issue.

Order accordingly.

Schedule A — Excerpts From the 2002 version of the Securities Act

R.S.O. 1990, c. S.5, as am. S.O. 1992, c. 18, s. 56; 1993, c. 27, Sched,; 1994, c. 11, ss. 349-381; 1994, c. 33; 1997, c. 10, ss. 36-41; 1997, c. 19, s. 23; 1997, c. 31, s. 179; 1997, c. 43, Sched F, s. 13; 1999, c. 6, s. 60; 1999, c. 9,

ss. 193-222 [s. 202 not in force at date of publication]; 2001, c. 23, ss. 209-218.

1. (1) Definitions — In this Act,

[...]

"material change", where used in relation to the affairs of an issuer, means a change in the business, operations or capital of the issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer and includes a decision to implement such a change made by the board of directors for the issuer or by senior management of the issuer who believe that confirmation of the decision by the board of directors is probable;

"material fact", where used in relation to securities issued or proposed to be issued, means a fact that significantly affects, or would reasonably be expected to have a significant effect on, the market price or value of such securities;

[...]

1.1 Purposes — The purposes of this Act are,

(a) to provide protection to investors from unfair, improper or fraudulent practices; and

(b) to foster fair and efficient capital markets and confidence in capital markets.

75. (1) *Publication of material change* — Subject to subsection (3), where a material change occurs in the affairs of a reporting issuer, it shall forthwith issue and file a news release authorized by a senior officer disclosing the nature and substance of the change.

(2) *Report of material change* — Subject to subsection (3), the reporting issuer shall file a report of such material change in accordance with the regulations as soon as practicable and in any event within ten days of the date on which the change occurs.

(3) *Idem* — Where,

(a) in the opinion of the reporting issuer, the disclosure required by subsections (1) and (2) would be unduly detrimental to the interests of the reporting issuer; or

(b) the material change consists of a decision to implement a change made by senior management of the issuer who believe that confirmation of the decision by the board of directors is probable and senior management of the issuer has no reason to believe that persons with knowledge of the material change have made use of that knowledge in purchasing or selling securities of the issuer,

the reporting issuer may, in lieu of compliance with subsection (1), forthwith file with the Commission the report required under subsec-

tion (2) marked so as to indicate that it is confidential, together with written reasons for non-disclosure.

(4) *Idem* — Where a report has been filed with the Commission under subsection (3), the reporting issuer shall advise the Commission in writing where it believe the report should continue to remain confidential within ten days of the date of filing of the initial report and every ten days thereafter until the material change is generally disclosed in the manner referred to in subsection (1) or, if the material change consists of a decision of the type referred to in clause (3)(b), until that decision has been rejected by the board of directors of the issuer.

76. (1) *Trading where undisclosed change* — No person or company in a special relationship with a reporting issuer shall purchase or sell securities of the reporting issuer with the knowledge of a material fact or material change with respect to the reporting issuer that has not been generally disclosed.

(2) *Tipping* — No reporting issuer and no person or company in a special relationship with a reporting issuer shall inform, other than in the necessary course of business, another person or company of a material fact or material change with respect to the reporting issuer before the material fact or material change has been generally disclosed.

(3) *Idem* — No person or company that proposes,

(a) to make a take-over bid, as defined in Part XX, for the securities of a reporting issuer;

(b) to become a party to a reorganization, amalgamation, merger, arrangement or similar business combination with a reporting issuer; or

(c) to acquire a substantial portion of the property of a reporting issuer,

shall inform another person or company of a material fact or material change with respect to the reporting issuer before the material fact or material change has been generally disclosed except where the information is given in the necessary course of business to effect the take-over bid, business combination or acquisition.

(4) *Defence* - No person or company shall be found to have contravened subsection (1), (2) or (3) if the person or company proves that the person or company reasonably believed that the material fact or material change had been generally disclosed.

(5) *Definition* - For the purposes of this section, "person or company in a special relationship with a reporting issuer" means,

(a) a person or company that is an insider, affiliate or associate of,

(i) the reporting issuer,

(ii) a person or company that is proposing to make a take-over bid, as defined in Part XX, for the securities of the reporting issuer, or

(iii) a person or company that is proposing to become a party to a reorganization, amalgamation, merger or arrangement or similar business combination with the reporting issuer or to acquire a substantial portion of its property,

(b) a person or company that is engaging in or proposes to engage in any business or professional activity with or on behalf of the reporting issuer or with or on behalf of a person or company described in subclause (a)(ii) or (iii),

(c) a person who is a director, officer or employee of the reporting issuer or of a person or company described in subclause (a)(ii) or (iii) or clause (b),

(d) a person or company that learned of the material fact or material change with respect to the reporting issuer while the person or company was a person or company described in clause (a), (b) or (c),

(e) a person or company that learns of a material fact or material change with respect to the issuer from any other person or company described in this subsection, including a person or company described in this clause, and knows or ought reasonably to have known that the other person or company is a person or company in such a relationship.

(6) *Idem* - For the purpose of subsection (1), a security of the reporting issuer shall be deemed to include,

(a) a put, call, option or other right or obligation to purchase or sell securities of the reporting issuer; or

(b) a security, the market price of which varies materially with the market price of the securities of the issuer.

122. (1) Offences, general — Every person or company that,

[...]

(c) contravenes Ontario securities law,

is guilty of an offence on conviction is liable to a fine of not more than $1,000,000 or to imprisonment for a term of not more than two years, or both.

[...]

(3) Directors and Officers — Every director or officer of a company or of a person other than an individual who authorizes, permits or acquiesces in the commission of an offence under subsection (1) by the company or person, whether or not a charge has been laid or a finding of guilt has been made against the company or person in respect of the offence under subsection (1), is guilty of an offence and is liable on conviction to a fine of not more than

$1,000,000 or to imprisonment for a term of not more than two years, or to both.

127. (1) Orders in the public interest — The Commission may make one or more of the following orders if in its opinion it is in the public interest to make the order or orders;

1. An order that the registration or recognition granted to a person or company under Ontario securities law be suspended or restricted for such period as is specified in the order or be terminated, or that terms and conditions be imposed on the registration or recognition.
2. An order that trading in any securities by or of a person or company cease permanently or for such period as is specified in the order.
3. An order that any exemptions contained in Ontario securities law do not apply to a person or company permanently or for such period as is specified in the order.
4. An order that a market participant submit to a review of his, her or its practices and procedures and institute such changes as may be ordered by the Commission.
5. If the Commission is satisfied that Ontario securities law has not been complied with, an order that a release, report, preliminary prospectus, prospectus, return financial statement, information circular, take-over bid circular, issuer bid circular, offering memorandum, proxy solicitation or any other document described in the order,
   i. be provided by a market participant to a person or company,
   ii. not be provided by a market participant to a person or company, or
   iii. be amended by a market participant to the extent that amendment is practicable.
6. An order that a person or company be reprimanded.
7. An order that a person resign one or more positions that the person holds as a director or officer of an issuer.
8. An order that a person is prohibited from becoming or acting as director or officer of any issuer.

[...]

Schedule B — National Policy 40

National Policy Statement 40 Timely Disclosure

A. Introduction

This policy statement applies to all issuers whose securities are publicly traded in Canada, including reporting issuers or the equivalent in any Canadian jurisdiction. It replaces Uniform Act Policy 2-12, and is effective as of December 1, 1987.

Where the requirements of the Policy go beyond the technical requirements of existing legislation, the securities administrators and stock exchanges re-

quest that issuers, their counsel, and market professionals regard such requirements as guidelines to follow in order to assist in the operation in Canada of an open and fair marketplace which merits the trust and confidence of the investing public.

Issuers are reminded that this policy statement does not replace the disclosure requirements set out in the provincial securities statutes and compliance with this Policy must be supplementary to compliance with the relevant provincial statutes. Moreover, if securities of an issuer are listed on one or more stock exchanges in Canada, the issuer must also comply with the rules of the relevant exchange(s) concerning timely disclosure.

Further, nothing in this Policy Statement abrogates from the discretion of a securities administrator to request information from an issuer or to issue cease trading orders or apply other sanctions within its jurisdiction where, in the view of the administrator, there is inadequate public disclosure as to the affairs of an issuer whose securities are publicly traded.

B. Basic Principle - Disclosure of Material Information

It is a cornerstone principle of securities regulation that all persons investing in securities have equal access to information that may affect their investment decisions. Public confidence in the integrity of the securities markets requires that all investors be on an equal footing through timely disclosure of material information concerning the business and affairs of reporting issuers and of companies whose securities trade in secondary markets. Therefore, immediate disclosure of all material information through the news media is required.

C. Determining the Relevant Regulatory Authority for Consultation, Disclosure and Filing of Material Information

The following sections discuss the meaning of "material information" and how such information is to be disclosed. This section discusses the general rules for determining which securities administrator and/or stock exchange is to be consulted for requirements relating to, and the disclosure and filing of, material information. Any references to "the relevant securities regulator" in the following commentary should refer to this part of the policy statement.

It is intended that the number of regulatory authorities that must be consulted in a particular matter be kept to a minimum. There are six general principles in determining the relevant securities regulator for consultation on, disclosure, and filing of material information. The particular rules that apply depend on the jurisdiction, whether the security is listed and, if so, the particular exchange on which the security is listed. These rules are as follows:

1. In the case of unlisted securities, the relevant securities regulator is the administrator in the jurisdiction having the principal market for the unlisted security.
2. In the case of securities listed on The Toronto Stock Exchange ("TSE"), the Montreal Exchange ("ME"), or the Vancouver Stock Exchange ("VSE") the stock exchange is the relevant securities reg-

ulator, although the issuer may consult with the securities administrator of the particular jurisdiction.

3. In the case of securities listed on any other Canadian stock exchange, both the stock exchange and the securities administrator in the jurisdiction having the principal market for the listed security are considered to be the relevant securities regulators.
4. In the case of securities listed on two or more Canadian stock exchanges, each stock exchange is a relevant securities regulator, and must be dealt with. The issuer may also consult with the securities administrator in the jurisdiction having the principal market for the listed security.
5. Material change reports and media releases must be filed in accordance with the requirements of legislation in jurisdictions having such legislation. See Part D.
6. The rules of all stock exchanges upon which securities are listed must be observed.

These rules for determining the relevant securities regulator for consultation, disclosure, and filing of material information are fundamental to the commentary that follows. For example, where a news release is required these rules will determine the relevant securities regulator(s) for disclosure and the jurisdiction(s) in which the news release must be filed.

D. Material Information

The requirement to disclose material information supplements the provisions of the Securities Acts of Alberta, British Columbia, Ontario, Quebec and Nova Scotia which require disclosure of any "material change" by issuing a press release, and filing with the securities administrator the press release in the case of Quebec, and the press release and a material change report in the case of Alberta, British Columbia, Ontario and Nova Scotia.

Definition

Material information is any information relating to the business and affairs of an issuer that results in or would reasonably be expected to result in a significant change in the market price or value of any of the issuer's securities.

Material information consists of both material facts and material changes relating to the business and affairs of an issuer. The market price or value of an issuer's securities is sometimes affected by, in addition to material information, the existence of rumours and speculation. Where this is the case, the issuer may be required to make an announcement as to whether such rumours and speculation are factual or not.

It is the responsibility of each issuer to determine what information is material according to the above definition in the context of the issuer's own affairs. The materiality of information varies from one issuer to another according to the size of its profits, assets and capitalization, the nature of its operations and many other factors. An event that is "significant" or major" in the context of a smaller issuer's business and affairs is often not material to a

larger issuer. The issuer itself is in the best position to apply the definition of material information to its own unique circumstances.

Consultation with Regulatory Authorities

Decisions on disclosure require careful subjective judgments and issuers are encouraged to consult on a confidential basis the relevant regulatory authority and, where applicable, the relevant exchange when in doubt as to whether disclosure should be made.

Immediate Disclosure

An issuer is required to disclose material information concerning its business and affairs forthwith upon the information becoming known to management, or in the case of information previously known, forthwith upon it becoming apparent that the information is material. Issuers are required to provide the relevant regulatory authority with a copy of any news release concurrently upon dissemination to the public.

Immediate release of information is necessary to ensure that it is promptly available to all investors and to reduce the risk that persons with access to that information will act upon undisclosed information. Unusual trading marked by significant changes in the price or trading volumes of any of an issuer's securities prior to the announcement of material information is embarrassing to management and damaging to the reputation of the securities market since the investing public may assume that certain persons benefited from access to material information which was not generally disclosed.

In restricted circumstances disclosure of material information may be delayed for reasons of corporate confidentiality. See Part G.

Developments to be Disclosed

Issuers are not generally required to interpret the impact of external political, economic and social developments on their affairs. However, if an external development will have or has had a direct effect on the business and affairs of an issuer that is both material (in a sense outlined above) and uncharacteristic of the effect generally experienced by other issuers engaged in the same business or industry, the issuer is urged to explain, where practical, the particular impact on them. For example, a change in government policy that affects most issuers in a particular industry does not require an announcement, but if it affects only one or a few issuers in a material way, such issuers should make an announcement.

The market price or value of an issuer's securities may be affected by factors relating directly to the securities themselves as well as by information concerning the issuer's business and affairs. For example, changes in an issuer's issued capital, stock splits, redemptions and dividend decisions may all impact upon the market price of a security.

Actual or proposed developments that are likely to give rise to material information and thus to require prompt disclosure include, but are not limited to, the following:

1. Changes in share ownership that may affect control of the issuer.

2. Changes in corporate structure, such as reorganizations, amalgamations etc.
3. Take-over bids or issuer bids.
4. Major corporate acquisitions or dispositions.
5. Changes in capital structure.
6. Borrowing of a significant amount of funds.
7. Public or private sale of additional securities.
8. Development of new products and developments affecting the issuer's resources, technology, products or market.
9. Significant discoveries by resource companies.
10. Entering into or loss of significant contracts.
11. Firm evidence of significant increases or decreases in near-term earnings prospects.
12. Changes in capital investment plans or corporate objectives.
13. Significant changes in management.
14. Significant litigation.
15. Major labour disputes or disputes with major contractors or suppliers.
16. Events of default under financing or other agreements.
17. Any other developments relating to the business and affairs of the issuer that would reasonably be expected to significantly affect the market price or value of any of the issuer's securities or that would reasonably be expected to have a significant influence on a reasonable investor's investment decision.

Disclosure is only required where a development is material according to the definition of material information. Announcements of an intention to proceed with a transaction or activity should be made when a decision has been made to proceed with it by the issuer's board of directors, or by senior management with the expectation of concurrence from the board of directors. However, a corporate development in respect of which no firm decision has yet been made but that is reflected in the market place may require prompt disclosure. See "Rumours" under Part E and Part G "Confidentiality".

Forecasts of earnings and other financial forecasts need not be disclosed, but where a significant increase or decrease in earnings is indicated in the near future, such as in the next fiscal quarter, this fact must be disclosed. Forecasts should not be provided on a selective basis to certain investors not involved in the management of the affairs of the issuer. If disclosed, they should be generally disclosed. Reference should be made to National Policy Statement No. 48, "Future-Oriented Financial Information".

E. Disclosure

Decisions as to the dissemination of information and the temporary halting of trading are, in the case of listed securities, usually made by the relevant

stock exchange, with or without consultation with the securities administrator of the jurisdiction. However, in certain circumstances, trading in a listed security may be halted as a result of a cease trading order issued by a securities administrator. Decisions relating to unlisted securities are made by securities administrators.

Timing of Announcements

The general principle is that significant announcements are required to be released immediately. This rule is subject to exception in certain situations for issuers whose securities are listed for trading on a stock exchange or other organized market (at this time only CDN in Ontario). Subject to the approval of the relevant securities regulator, release of certain announcements may be delayed until the close of trading, provided the material information is not reflected in the price of the stock. Issuer officials are encouraged to seek assistance and direction from the relevant securities regulator as to when an announcement should be released and whether trading in the issuer's securities should be halted for dissemination of an announcement.

Pre-Notification

The policy of immediate disclosure frequently requires that media releases be issued during trading hours, especially when an important corporate development has occurred. Where this is so, it is essential that issuer officials notify the relevant securities regulator by telephone prior to issuance of a media release. The relevant securities regulator will then be able to determine whether trading in any of the issuer's securities should be temporarily halted.

Where a media release is to be issued during trading hours, securities administrators of provinces in which there is a market for the securities and stock exchanges or where securities are listed should be supplied with a copy forthwith upon its release.

Trading Halts

If an announcement is to be made during trading hours, trading in the stock may be halted until the announcement is made public and disseminated. The relevant securities regulator will determine the amount of time necessary for dissemination in any particular case, which determination will be dependent upon the significance and complexity of the announcement. Issuers should understand that a trading halt does not reflect upon the reputation of an issuer's management nor upon the quality of its securities, but is simply for the purpose of providing for adequate dissemination of the relevant information.

In order to determine whether a trading halt is justified, the relevant securities regulator will consider the impact which the announcement is expected to have on the market for the issuer's securities. Any trading halts that are imposed are normally for less than a two hour duration. Where an issuer's securities are listed or traded elsewhere, those exchanges or other markets will coordinate trading halts. There is a convention among exchanges, NAS-

DAQ and CDN that trading in a security traded or listed in more than one market shall be halted and resumed at the same time in each market.

Rumours

Unusual market activity is often caused by the presence of rumours. If the issuer makes a public statement about a rumoured activity, the disclosure must be accurate and not misleading. It is impractical to expect management to be aware of, and comment on, all rumours, but when market activity indicates that trading is being unduly influenced by rumour the relevant securities administrator will request that the issuer make a clarifying statement. A trading halt may be imposed pending a "no corporate developments" statement from the issuer. If a rumour is correct in whole or in part, the issuer, in response to the request, must make immediate disclosure of the relevant material information and a trading halt may be imposed pending release and dissemination of that information.

F. Dissemination

Transmission to Media

A media release should be transmitted to the media by the quickest possible method and in a manner which provides for wide dissemination. Media releases should be made to news services that disseminate financial news nationally, to the financial press and to daily newspapers that provide regular coverage of financial news.

Content of Announcements

Announcements of material information should be factual and balanced, neither overemphasizing favourable news nor underemphasizing unfavourable news. Unfavourable news must be disclosed just as promptly and completely as favourable news. While it is clear that news releases may not be able to contain all the details that would be included in a prospectus or similar document, news releases should contain sufficient detail to enable media personnel and investors to appreciate the true substance and importance of the information so that investors may make informed investment decisions. The guiding principle should be to communicate clearly and accurately the nature of the information, without including unnecessary details, exaggerated reports or editorial commentary designed to colour perception of the announcement. The issuer should be prepared to supply further information when appropriate; the name and telephone number of the company official available for comment should be provided in the release.

Misleading Announcements

While all material information must be released immediately, the timing of an announcement of material information must be handled carefully, since either premature or late disclosure may damage the reputation of the securities market. Misleading disclosure activity designed to influence the price of a security is improper. Misleading news releases send signals to the investment community which are not justified by an objective examination of the facts, and may detract from the issuer's credibility. Announcements of an

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intention to proceed with a transaction or activity should not be made unless the issuer has the ability to carry out the intent (although proceeding may be subject to contingencies) and a decision has been made to proceed with the transaction or activity by the issuer's board of directors, or by senior management with the expectation of concurrence from the board of directors.

G. Confidentiality

When Information May be Kept Confidential

In certain circumstances disclosure of material information concerning an issuer's business and affairs may be delayed and kept confidential temporarily where immediate release of the information would be unduly detrimental to the issuer's interests. In such a situation, issuers are required under the law of certain provinces to disclose to the securities administrator on a confidential basis, information that is not being disclosed immediately to the public. Issuers are reminded of subsection 75(4) of the Securities Act (Ontario), subsection 67(3) of the Securities Act (British Columbia), subsection 118(3) of the Securities Act (Alberta), subsection 84(3) of the Securities Act, 1988 (Saskatchewan), subsection 81(4) of the Securities Act (Nova Scotia), and subsection 76(4) of the Securities Act (Newfoundland) which stipulate that a reporting issuer that wishes to keep information confidential must renew that request every 10 days. Subsection 118(4) of the Securities Act (Alberta) also provides, however, that a reporting issuer must file and issue a news release and file a material change report not later than 180 days from the day such changes became known to the issuer. Section 74 of the Securities Act (Quebec) provides that a reporting issuer need not prepare a press release where senior management has reasonable grounds to believe not only that disclosure would be seriously prejudicial to the issuer, but also that no transaction in the issuer's securities has been or will be carried out on the basis of the information not generally known. The issuer must issue and file a press release only once the circumstances justifying non-disclosure have ceased to exist.

Examples of instances in which disclosures might be unduly detrimental to an issuer's interests are where:

(1) Release of the information would prejudice the issuer's ability to pursue specific and limited objectives or to complete a transaction or series of transactions that are under way. For example, premature disclosure of the fact that an issuer intends to purchase a significant asset may increase the cost of the acquisition.

(2) Disclosure of the information would provide competitors with confidential corporate information that would significantly benefit them. Such information may be kept confidential if the issuer is of the opinion that the detriment to it resulting from disclosure would outweigh the detriment to the market in not having access to the information. A decision to release a new product, or details on the features of a new product, may be withheld for competitive reasons, but

such information should not be withheld if it is available to competitors from other sources.

(3) Disclosure of information concerning the status of ongoing negotiations would prejudice the successful completion of those negotiations. It is unnecessary to make a series of announcements concerning the status of negotiations with another party concerning a particular transaction. If it seems that the situation is going to stabilize within a short period, public disclosure may be delayed until a definitive announcement can be made. Disclosure should be made once "concrete information" is available, such as a final decision to proceed with the transaction or, at a later point in time, finalization of the terms of the transaction.

Withholding of material information on the basis that disclosure would be unduly detrimental to the issuer's interests can only be justified where the potential harm to the issuer or to investors caused by immediate disclosure may reasonably be considered to outweigh the undesirable consequences of delaying disclosure. While recognizing that there must be a trade-off between an issuer's legitimate interest in maintaining secrecy and the investing public's right to disclosure of corporate information, securities administrators and stock exchanges discourage delaying disclosure for a lengthy period of time since it is unlikely that confidentiality can be maintained beyond the short term.

Maintaining Confidentiality

Where disclosure of material information is delayed, the issuer must maintain complete confidentiality. In the event that such confidential information, or rumours respecting the same, is divulged in any manner (other that in the necessary course of business), the issuer is required to make an immediate announcement on the matter. The relevant securities regulator must be notified of the announcement, in advance, in the usual manner. During the period before material information is disclosed, market activity in the issuer's securities should be closely monitored by the issuer. Any unusual market activity probably means that news of the matter is being disclosed and that certain persons are taking advantage of it. In such case, the relevant securities regulator should be advised immediately and a halt in trading will be imposed until the issuer has made disclosure on the matter.

At any time when material information is being withheld from the public, the issuer is under a duty to take precautions to keep such information completely confidential. Such information should not be disclosed to any of the issuer's officers, employees or advisers, except in the necessary course of business. The directors, officers and employees of an issuer should be reminded on a regular basis that confidential information obtained in the course of their duties must not be disclosed.

H. Insider Trading

Issuers should make insiders and others who have access to material information about the issuer before it is generally disclosed aware that trading in

securities of the issuer while in possession of undisclosed material information or tipping such information is an offence under the securities laws of a number of jurisdictions, and may give rise to civil liability.

In any situation where material information is being kept confidential because disclosure would be unduly detrimental to the issuer's best interests, management is under a duty to take every possible precaution to ensure that no trading whatsoever takes place by any insiders or persons in a "special relationship" with the issuer in which use is made of such information before it is generally disclosed to the public.

In the event that a stock exchange or securities administrator is of the opinion that insider or improper trading may have occurred before material information has been disclosed and disseminated, that stock exchange or securities administrator may require that an immediate announcement be made disclosing such material information.

I. Recipients of Communications

Material change reports and media releases should be delivered to the Market Surveillance Branch or the equivalent in all jurisdictions where there is a legal requirement to file such reports and media releases.

Confidential communications should be made as follows:

> British Columbia Securities Commission - Deputy Superintendent, Registration & Statutory Filings or, if unavailable, Deputy Superintendent, Compliance & Enforcement, or Superintendent of Brokers
>
> Alberta Securities Commission - Director, Market Standards
>
> Saskatchewan Securities Commission - Registrar or, if unavailable, Chairman
>
> Manitoba Securities Commission - Director or, if unavailable, Chairman or Senior Counsel
>
> Ontario Securities Commission - Office of the General Counsel
>
> Commission des valeurs mobilières du Québec - Directeur du contentieux, or, if unavailable Vice-President or President
>
> Government of New Brunswick - Administrator of the Securities Act
>
> Nova Scotia Securities Commission - Director, Securities
>
> Government of Newfoundland and Labrador - Director of Securities
>
> Government of Prince Edward Island — Registrar
>
> Office of the Registrar of Securities for the Northwest Territories — Registrar
>
> Office of the Registrar of Securities for Yukon Territory - Registrar of Securities or, if unavailable, Deputy Registrar of Securities

It is suggested that confidential written communications be made in sealed envelopes within outer envelopes.

Re. Canwest Global Communications

Court File No. 09-8396-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

Proceeding commenced at Toronto

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