1.2 RESTRICTED SHARES

1.1 Position Paper on Restricted Shares

The following insert is the Commission's Position Paper - Draft and Interim Policy on Restricted Shares and Request for Comments. The Position Paper was released on Friday, March 2nd, 1984 and certain requirements relating to restricted shares are being adopted effective on that date. The Commission is requesting comments of interested parties by April 13, 1984.

POSITION PAPER

DRAFT AND INTERIM POLICY ON RESTRICTED SHARES AND REQUEST FOR COMMENTS

ONTARIO SECURITIES COMMISSION

March 2, 1984

POSITION PAPER

DRAFT AND INTERIM POLICY ON RESTRICTED SHARES AND REQUEST FOR COMMENTS

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I SUMMARY

A. General

The regulation of non-voting, subordinate voting and restricted voting residual equity shares has concerned Canadian securities regulators for a number of years. In 1981, after requesting and receiving comments on the issues raised by the increasing use of such shares by issuers in the Canadian capital markets, certain of the Canadian securities administrators held or participated in public hearings to consider the appropriate regulation, if any, of such shares. These hearings resulted in a decision by the Ontario Securities Commission to adopt a disclosure oriented policy and to defer resolving a number of other issues raised at the hearings until the reaction of the public markets to the proliferation of restricted shares as a financing tool could be further analysed.

Since the 1981 hearings, the use of restricted shares as a financing device has increased. As shown in Table 2 on page 8, the aggregate number of Toronto Stock Exchange (the "TSE") listed restricted shares increased by about 50% in 1983. In the last year, some senior issuers in the Canadian markets have reorganized their capital to create or increase the number of restricted shares.

In recent months the Commission has been approached informally by institutional investors, both individually and in groups, by representatives of underwriting and brokerage firms and by individual investors to express their concerns and to ask the Commission to take steps to

control the use of restricted shares. The Commission has also received submissions from issuers as to the appropriateness of the use of these shares for financing in particular circumstances. In addition, the use of restricted shares has received considerable coverage in the financial media.

The Commission has a responsibility to provide a regulatory framework within which orderly capital markets can function. For the Commission to abolish restricted shares might create more serious problems for the capital markets than the problems created by restricted shares. The other extreme in a regulatory approach is to rely totally upon disclosure, which is the current approach to regulating restricted shares. The Commission believes that it must take a more active role in regulating the use of restricted shares than simply requiring disclosure of the attributes of the shares in appropriate circumstances.

Therefore, after careful consideration of the issues involved in the regulation of restricted shares, the Commission has arrived at a preliminary decision to take certain immediate steps to deal with the problems that test investor confidence and to propose amendments to the disclosure requirements in the existing policy to ensure adequate disclosure for investors. The Commission believes that the appropriate approach to dealing with problems surrounding the creation of restricted shares is to give investors a stronger voice in the corporate action required to create these shares and to prescribe certain minimum standards for the terms of these shares to protect holders in the event of a take-over bid for the **issuer.** These measures, together with an increasing awareness by the investment community of the restrictions upon holders of these shares, will, it is hoped, allow the destiny of this financing device to be determined in the markets.

These requirements are imposed as interim measures. Prior to finalizing its position, the Commission is requesting comments from investors, public companies, securities firms and all other interested parties on the intiatives taken by the Commission and generally on the issues raised by restricted shares.

The Commission recognizes that the use of restricted shares may have implications for the economy that go beyond the efficiency of the capital markets and therefore seeks the comments of interested parties on the appropriate forum for dealing with such implications.

B. Amendments to Policy 1.3

Effective March 2, 1984 the Commission has approved amendments to OSC Policy 1.3, "Restricted Shares (Uncommon Equities) - Distributions and Disclosure" ("Policy 1.3"), to provide as follows:

1. A receipt will not be issued for any prospectus offering shares of any class or series of restricted shares and statutory exemptions will be denied in connection with any offering of such shares by way of a rights offering, securities exchange take-over bid, reorganization or amalgamation, unless the shares include in their attributes protective provisions designed to ensure that holders of restricted shares have an opportunity to participate in any take-over bid made for the common shares of the issuer (or in any other change in control) where an offer on the same terms and conditions is not made simultaneously for the restricted shares. On an interim basis, this policy will not apply to distributions of restricted shares without protective provisions made pursuant to prospectus exemptions that do not involve wide public distributions of shares (e.g., private placements, trades to employees, etc.).

2. Where an issuer proposes a fundamental change, such as a reorganization or amalgamation, that would have the effect of converting existing common shares into restricted shares or a combination of restricted and other shares, or proposes to distribute restricted shares to its common shareholders by way of stock dividend (other than pursuant to a normal course dividend in lieu of a cash dividend) or otherwise, the prospectus exemptions for the reorganization, amalgamation or other distribution will be denied unless the transaction is approved by a majority of the minority shareholders.

3. Where a voluntary offer for restricted shares is made, the provisions of Part XIX of the Securities Act (the "Act") shall be complied with. (The Commission is in the process of preparing draft amendments to the Act that, if enacted, would make Part XIX applicable to purchases of non-voting equity shares where the purchases would exceed 20% of the outstanding securities of that class.)

Amendments to Policy 1.3 are also being made to delete spent provisions and to amend and clarify the current disclosure provisions of Policy 1.3. These latter amendments are draft amendments and will not be effective until the Policy becomes final. A revised version of the Policy, blacklined to indicate where amendments have been made, will be published in the next few days.

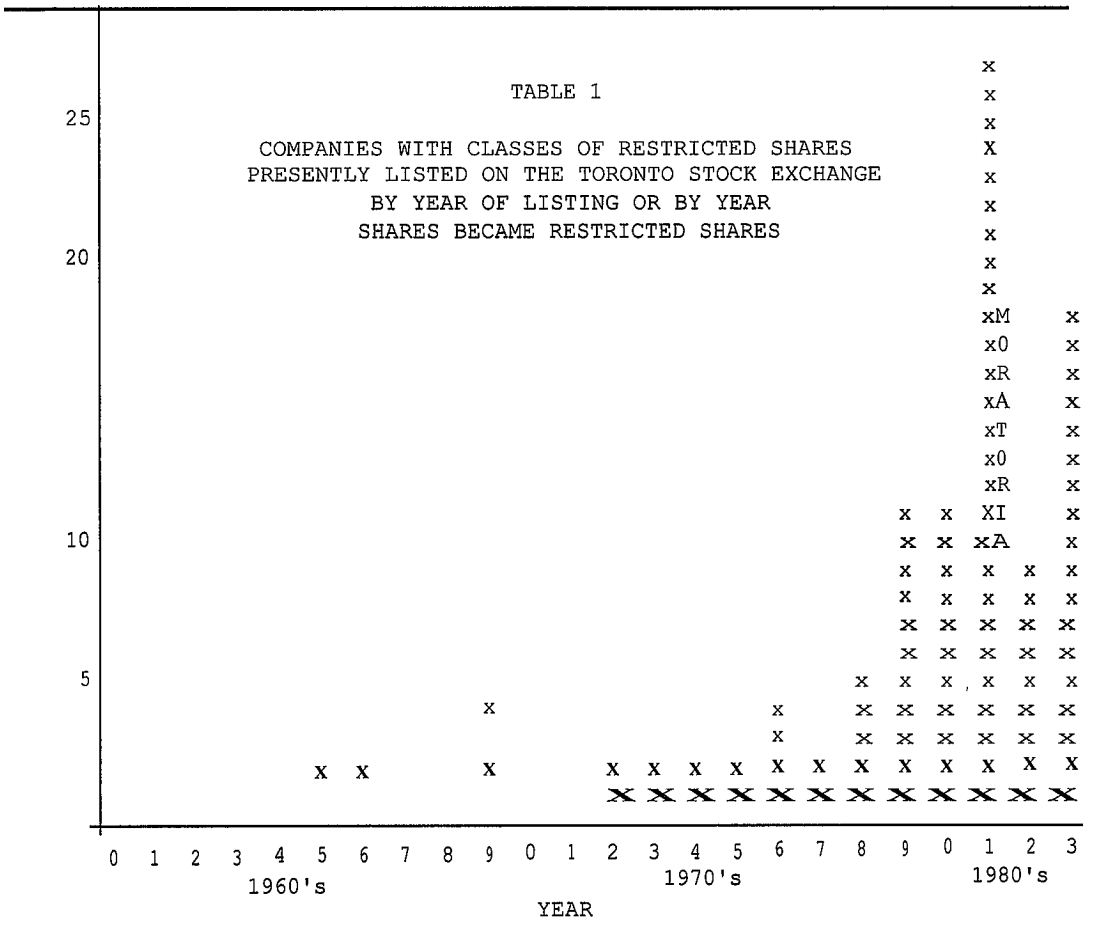
C. Effective Date

The amendments described in paragraphs .1 to 3 above are effective immediately. The amendments to the disclosure provisions of the current Policy 1.3, referred to in the immediately preceding paragraph, will not be effective until the final form of Policy 1.3 has been settled.

II BACKGROUND

A. 1981 Hearings

"Residual equity" shares with no voting rights, or with voting rights that are subordinate to another class having greater voting rights, have been used by Canadian corporate financiers for decades. The Commission has determined that such shares should be referred to as "restricted shares". In this paper the phrase "residual equity shares" means shares that carry a residual right to participate in earnings and in assets upon liquidation or winding-up to an unlimited degree. Of the classes of non-voting, subordinate voting and restricted voting residual equity shares currently listed on the TSE, seven classes were listed in the 1940's, 13 in the 1950's and 12 in the 1960's. However, it was not until the dramatic increase in the number of companies with restricted shares in the late 1970's and 1980 that restricted shares came to the attention of the securities regulators. (See Table 1 below for the increase, on a yearly basis, in the number of TSE listed companies with restricted shares.)



In October, 1980 the TSE published, as a Notice to Members, a Discussion Paper on "the Listing of Non-Voting, Multiple Voting or Restricted Voting Common Shares" and requested comments on the appropriateness of the TSE continuing its policy of listing such shares. The Discussion Paper was also published in the OSC Bulletin with a request that comments be sent to both the TSE and OSC. In May, 1981 the OSC announced its intention to hold a public hearing on the listing of such shares on the TSE. Six weeks later the Commission issued OSC Interim Policies 3-58 and 3-59 mandating disclosure and effecting a moratorium on the use of uncommon equity securities (i.e. restricted shares). The TSE announced a moratorium on the listing of restricted shares and the securities regulatory bodies in British Columbia and Quebec imposed similar moritoria.

In September of 1981, the Commission and securities administrators of Quebec, Alberta and British Columbia held public hearings on the regulation of non-voting, multiple voting and restricted voting "common" shares. Following the hearings, the Commission published a revised OSC Policy 3-58. Policy 3-58 was published on January 22, 1982 and was then republished, with certain technical changes, on April 2, 1982. The latter version was carried forward as Policy 1.3 when the Commission's Policy Statements were revised and renumbered at the end of 1982. The Commission des valeurs mobilieres du Quebec ("QSC") issued a decision to similar effect and the British Columbia Superintendent of Brokers ("B.C. Superintendent") adopted a similar policy. The TSE and the Montreal Exchange also adopted comparable policies.

B. Policy 1.3

Policy 1.3 in its present form is disclosure oriented. It requires that restricted shares be appropriately described in reporting issuer disclosure documentation,

offering documents, stock quotations, trade confirmations and monthly statements and dealer and adviser literature. It requires that holders of restricted shares be sent all informational documents that are sent to holders of voting shares and that the former be given notice of and be invited to attend meetings of voting shareholders.

Policy 1.3 does not, however, deal with a number of issues that were canvassed at the hearings, including the impact of restricted shares on:

(i) shareholder democracy and the rights of minority shareholders;

(ii) the efficiency of the capital markets; and

(iii) investor protection and, in particular, the treatment of holders of restricted shares when there is a take-over bid for the common shares.

That these issues would ultimately have to be addressed was suggested in the preamble to Policy 3-58 where the Commission stated:

> A number of complex issues were raised at the hearings that are not dealt with in this Policy Statement. It is intended to consider these matters further, as well as the operation of this Policy Statement in the market place and addenda to this Policy Statement may issue.

C. Proliferation of Restricted Shares After 1981 Hearings

During 1982, there was a decrease in the number of new classes of restricted shares being listed on the TSE. From a high of 28 in the first half of 1981 (the moratoria were in effect for the second half of the year), new listings of restricted shares dropped to only nine in 1982. The decrease can be attributed to at least two factors. Firstly, the TSE moratorium was not lifted until April, 1982 and it took some time for companies to absorb the new

OSC and TSE policies on restricted shares, plan a new issue or reorganization, effect it and obtain a listing. Secondly, during most of 1982, the capital markets were relatively inactive as the Canadian economy pulled itself out of a deep recession. As time elapsed and the economy began to turn around, a large number of issuers seized the opportunity to reduce their debt-equity ratios by issuing shares. Many of these issuers took the preliminary step of creating new classes of restricted shares prior to their public offerings and, as a result, the number and market value of publicly-traded restricted shares rose dramatically. In 1983, the first complete calendar year after the adoption of the TSE and OSC policies on restricted shares and the lifting of the moratoria, 18 listed companies created restricted shares. In addition, a number of companies with classes of restricted shares already listed on the TSE engaged in major distributions of such shares. One can get some idea of the magnitude of the proliferation of restricted shares by looking at the following statistics for companies listed on the TSE:

TABLE 2

RESTRICTED SHARES LISTED ON THE TORONTO STOCK EXCHANGE:
NUMBER OF COMPANIES, NUMBER OF SHARES AND
MARKET VALUE OF SHARES
(YEARS ENDED DECEMBER 31)

	1979	1980	1981	1982	1983
Number of companies with listed restricted shares	64	75	103	112	130
Aggregate number of restricted shares on TSE (millions)	323	410	649	703	1088
Aggregate market value of listed restricted shares ($ billions based on year-end prices)	4.57	7.24	6.79	6.76	12.32

As can be seen, both the number of restricted shares and the market value of such shares listed on the TSE increased substantially in 1983. Over the last four

years, the number of companies with listed classes of restricted shares has doubled and the aggregate number of such shares has more than tripled.

D. Recent Developments

In recent months the issues relating to the regulation of restricted shares have been drawn once again to the attention of regulators as a result of actions taken by a number of issuers to reclassify their existing shares into restricted shares or to issue additional restricted shares and the response of investors and the financial media. Among the issuers that have either effected such a reclassification or made a major restricted share distribution in the last year are the following:

Consumers Distributing Company Limited,
Oakwood Petroleums Ltd.,
Norcen Energy Resources Limited,
Canadian Tire Corporation, Limited,
Trizec Corporation Ltd., and
Denison Mines Ltd.

An interesting recent development has been the change in the attitude of investors. and, in particular, institutional investors. The 1981 hearings were instigated by the securities commissions and stock exchanges, not by investors. Companies with restricted shares responded out of concern that their shares might be affected. Of the 95 submissions made to the TSE Discussion Paper and the OSC hearing, only two were made by investors. In 1981, investors did not appear to be seriously concerned about the spread of restricted shares. This appears to have changed. In recent months, the Commission has been approached by a number of investors and their representatives to voice their concerns. Approaches have been made by institutions individually and in groups, by investment dealers and brokers and by individual investors. Probably the most striking example of the growing sensitivity of institutional investors was the

reorganization of Norcen Energy Resources Limited in late 1983. Although the split of common shares into common shares and non-voting shares was approved by the required two-thirds majority, it came close to being defeated as a result of opposition from institutional investors. Press reports indicated that 30% of the shares represented at the meeting voted against the motion with most of the opposition coming from large institutional investors, including Canada Life Assurance Co., the Caisse de Depet et Placement du Quebec and the Ontario Municipal Employees Retirement Board.

The use of restricted shares as a financing device has also been the subject of extensive comment in the financial media including a number of editorials. The editorials have generally called for the abolition of the use of these shares.

III ISSUES IN THE REGULATION OF RESTRICTED SHARES AND APPROACH TO REGULATION

A. The Issues

The issues raised by the proliferation of non-voting and other restricted shares are wide ranging. The following discussion of the issues is designed to be extensive in order to generate as wide and detailed public response as possible. The Commission does not suggest that all the issues raised are within the jurisdiction of the Commission. Some issues, in particular those relating to concentration of power, are clearly concerns that go beyond the mandate of the Commission.

1. Disclosure. Policy 1.3 is disclosure oriented. Are the present disclosure requirements adhered to? Are they effective or adequate? What effect has disclosure had in the market? Are the requirements of fairness and investor protection adequately served by disclosure? If disclosure is not adequate, should the Commission set minimum standards for restricted shares or should restricted shares simply be prohibited?

2. Take-Over Bids and Other Business Combinations. Should the holders of restricted shares have an equal opportunity to participate on comparable terms in a take-over bid for common shares or other forms of merger? If so, should the ability to participate be dealt with in legislation or should it be dealt with by denying a receipt for a prospectus and by removal of prospectus exemptions where the attributes of the share capital of the target do not include protective provisions to ensure that holders of restricted shares will have an equal opportunity to participate in a take-over bid or other form of acquisition of control? Should any denial of prospectus exemptions extend to all exemptions or only to those involving major public distibutions? Should any such requirement be mandatory for existing classes or series of restricted shares, for the issuance of additional shares of an existing class or series of such shares or only for the creation of new classes or series of restricted shares?

3. Part XIX of the Act. Should the take-over bid framework, Part XIX of the Act, apply to voluntary purchases of non-voting shares in excess of the 20% level? This would ensure that holders of non-voting shares are provided with the same procedural and substantive protections as are available to holders of voting securities when bids are made for them (i.e. adequate information, sufficient time to form a reasoned judgement, etc.).

4. Oppression of Minority Shareholders. Are majority shareholders, directors and management who propose the creation of restricted shares acting in their own self interest rather than in the interests of the issuer or shareholders as a whole? Are restricted shares being created for the benefit of the corporation or for the benefit of the controlling shareholder of the corporation? Should reorganizations and amalgamations that change common shares into restricted shares (or

into common and restricted shares) be subject to minority approval on the basis that restricted shares are being created, or are perceived to be created, for the benefit of the controlling shareholders? Should the required level of minority approval be a simply majority, two-thirds or some other level? Should the controlling shareholder be permitted to use the corporate proxy machinery to solicit votes in favour of the reorganization or amalgamation? Are other criteria of fairness more appropriate for such transactions (e.g., committee of independent directors)?

5. Control and Ownership. Through the use of restricted shares it is possible for a person or company to control a major public corporation with minimal equity investment. A number of questions are raised by this.

Where the controlling shareholder has little or no equity in a public corporation and that corporation has a relationship, through share ownership, contract or otherwise, with an entity in which the controlling shareholder of the public corporation has a major equity stake, is there a greater incentive to divert cash flow, profits or corporate opportunities to such entity? To what extent are the incentives or dangers greater where control is held through the use of restricted shares (i.e. majority of the votes but less than 50% of the equity and perhaps a negligible equity interest) as opposed to control through ownership of the equity as well as votes (i.e. ownership of a majority of the common shares where there are no restricted shares)?

Should the Commission permit restricted shares only if common shares represent a certain specified percentage of the residual equity shares of an issuer? The effect of such a requirement would be that a controlling shareholder would have to have a certain minimum percentage of risk equity invested in the enterprise in order to exercise control. Should a

reporting issuer have a certain percentage of public equity investment in common shares before the issuer is permitted to issue restricted shares? Should existing classes or series of restricted shares be exempted from any such requirements?

6. Shareholder Rights. Shareholder democracy is impaired by the issuance of restricted shares in that a higher proportion of "risk equity" investors do not have a vote in the election of directors and other corporate matters. Voting rights are critical to holding management accountable and removing inefficient management. Corporate law has in recent years recognized the inappropriateness of removing voting rights in all circumstances by providing that where certain fundamental changes are proposed the holders of shares are entitled to vote "whether or not such shares otherwise carry the right to vote". However, a number of the statutory rights provided to minority shareholders under corporate and securities law are still tied to being a holder of voting securities. Is shareholder democracy unduly impaired by the increasing use of restricted shares? Is inefficient management too insulated from change? Will the impairment of shareholder democracy result in a greater need for intervention by the Commission or some other Government agency?

What is the long-term impact upon the efficiency of our capital markets of the increasing use of restricted shares as a financing device? Will investors ultimately doubt the accountability of management/controllers who have a disproportionately small equity interest, thereby discouraging investor participation in our capital markets?

7. Market for Corporate Control. The use of restricted shares permits shareholders with effective control to maintain their control without a corresponding equity investment when the issuer raises financing in the equity markets through the sale of restricted shares.

In the long term this can reduce the proportion of widely-held issuers that are not controlled by a single shareholder or group resulting in fewer issuers the control of which is available *through* an auction market. Is an open market for control a positive method of capital allocation for the Canadian economy? Is frustration of this market harmful to the long term health of the public share ownership system? Is it consistent with public policy in Ontario (which requires that minority shareholders be given an opportunity to participate in premiums paid for control) to allow corporate control to shift to and be consolidated in existing controlling shareholders through the use of restricted shares?

8. Concentration of Power. Corporate concentration has been with us for some time. While some regulation of concentration has been considered necessary to protect the public interest, concentration per se has not been viewed as inimical to the public interest. However, the restricted share phenomenon brings to the issue a new aspect which, to date, has not been adequately studied. Through the use of restricted shares, one person or company can control substantial assets without a significant equity investment (in a relative sense) and without being accountable to the "owners" of the assets. Is concentration of power over the major enterprises of the country in the public interest? Should mechanisms that facilitate such concentration be permitted?

The issuance of restricted shares permits a person to maintain control in perpetuity despite his failure to participate in any further risk equity financing by the issuer. This raises some interesting questions in terms of

the evolution of the capital markets and capitalism, Canadian style. In the United States, control of the major corporations went through several stages during the last century. The first stage was from 100% ownership by a person or family to majority control by such person or family, and then from majority control to "working" or "effective" control. The final stage was from effective control by one shareholder to management control of a widely held company. A key factor in this evolution was the inability of the controlling shareholder to maintain his proportionate investment in the risk capital of the corporation (i.e., common shares) as a result, on the one hand, of taxation and other factors having an impact on the controlling shareholder and, on the other hand, of the corporation's continuing need to finance through the issuance of additional risk equity. A far greater proportion of the major public corporations in the United States are widely held than is the case in Canada, where most major public corporations are effectively or legally controlled.

The following excerpts from the report entitled "The Regulation of Take-Over Bids in Canada: Premium Private Agreement Transactions" (the "Industry Take-Over Bid Report"), that was prepared by the Securities Industry Committee on Take-Over Bids and published in November, 1983, set out the relative levels of control in the American and Canadian capital markets:

> 9. As of February 18, 1983, there were 283 companies having shares included in the TSE 300 Composite Index. The Stock Price Index staff of the Exchange must monitor the public float of each stock included in the Index in order to determine the shares' eligibility for inclusion in the Index. The staff consider stocks having no holdings of 20 percent or more to be widely held. Share holdings of 20 percent or more, but less than 50 percent, may be deemed to constitute effective control, while share holdings of 50 percent and up constitute legal control. Using these working

definitions, the following is a summary of the extent of control in the TSE 300 Composite Index. The number of companies subject to legal control includes 19 companies whose restricted shares -- be they non-voting, subordinate voting or restricted voting -- are included in the Index but whose common shares are not listed on the Exchange and are held by one shareholder or a small group of shareholders.

	Number of Companies	%
Legal Control (50% or more).....	137	48.4
Effective Control (20%-49.9%).....	85	30.0
Widely Held.....	61	21.6
TOTAL.....	283	100.0

Cf. note 89, infra.

Of the "widely held" Canadian companies a significant number are regulated companies such as banks and utilities. Note 89 provides comparable statistics for the American capital markets.

89. The following table shows the extent of control in the companies included in the Standard & Poor's 500 Index:

	Number of Companies	%
Legal Control (50% or more).....	6	1.2
Effective Control (20%-49.9%).....	68	13.6
Widely Held.....	426	85.2
TOTAL.....	500	100.0

With the proliferation of restricted shares we can be assured that although the majority of Canadian public companies may one day be widely owned, most will continue to be closely controlled.

B. Approach to Regulation

In determining what role the Commission has in addressing the issues raised by restricted shares, the Commission must be governed by its mandate: to provide a regulatory environment in which efficient capital markets operate and develop. Efficiency is promoted through measures, such as disclosure requirements, designed to protect investors from market abuses. Efficiency is also promoted through measures that complement, or in some circumstances, replace, the corporate law to require acceptable standards of conduct by corporations, their managers and controlling shareholders. Certain of the issues raised by restricted shares fall within the jurisdiction of the Commission (and of the other securities administrators and self-regulatory bodies). However, some of the other issues listed above raise economic, social and political questions within the Legislature's rather than the Commission's jurisdiction. Like the capital markets, the questions raised transcend provincial boundaries. Cooperation is needed to deal with the issues both among the provincial securities administrators and among Federal and Provincial Governments. Depending upon the response to this position paper, the Commission may propose that the issues in the regulation of restricted shares beyond the Commission's current proposals ultimately be referred to the Ontario Government with a suggestion that the problems and issues be studied by some commission or agency, preferably one with representation from the Federal and various Provincial Governments. However, at least in the near term, the Commission believes that restricted shares are essentially capital market concerns that should be addressed by securities regulators.

Given the importance of the issues and the recent proliferation of restricted shares, the Commission

considers that it is both necessary and proper for it to take certain immediate measures to preserve public confidence in the public share ownership system and to redress the imbalance in bargaining power where restricted shares are being created. With these initiatives, restricted shares will be put to a market test so that the issues they raise may be more comprehensively studied and resolved. The appropriate method of putting such measures into effect is to amend Policy 1.3.

IV DISCUSSION OF ADDITIONS AND AMENDMENTS TO POLICY 1.3

A. Protective or "Coat-Tail" Provisions

Although it is now more common for issuers of restricted shares to provide protection for holders of restricted shares in take-over bid situations, the practice is not yet universal. The Industry Take-Over Bid Report stated that at November 16, 1983, there were 133 classes of restricted shares listed on the TSE and the Montreal Exchange; of these, only 40 had protective or "coat-tail" provisions (most of these were recently created issues of restricted shares).

Protective or coat-tail provisions refer to provisions included in the attributes of restricted shares that encourage or ensure that the holders of restricted shares will have an opportunity to participate in any take-over bid for the common shares, generally through a right of conversion if no comparable offer is made to them. A comparable offer would be an offer for the restricted shares made at the same time and on the same terms and conditions as the offer for the common shares.

Existing protective provisions vary. In some cases they are imperfect in that they do not ensure that the holders of restricted shares will have an opportunity to participate in a take-over bid or other change in control on the same terms as the holders of common shares. For example the right of conversion (or other right) may not be

triggered until after completion of the take-over bid for the common shares. In such a situation the offeror may have an incentive to make an offer for the restricted shares, since failure to do so may result in dilution of its voting position. However, the offeror is not required to make an offer and if an offer is made it need not be on the same terms and conditions as were offered to the holder or holders of the common shares.

The Commission believes that it is inequitable and contrary to the public interest to allow corporations to raise equity capital through restricted share issues without imposing a requirement of equal treatment in a take-over bid or other sale of control situation for the reasons stated in the following excerpt from the Industry Take-Over Bid Report:

> ...the Securities Industry Committee initially concluded that a capital structure including both common shares and restricted or special common shares might be used as a way of allowing a controlling shareholder to garner a premium on selling control while maintaining the principle that within a class all shares are equal. However, as its deliberations proceeded, the Securities Industry Committee reconsidered whether, if equal treatment within a class is to be the rule, the rule should logically extend to all classes of residual equity shares. This position would be advanced on the theory that if fairness and investor confidence are primary concerns, then consistency and the goal of real equality of treatment require that restricted or special common shares, which represent equity ownership in an enterprise, should be included in any premium control transactions. As a consequence, provisions ensuring that the owners of such shares would have an opportunity to participate in a take-over bid for the common shares ("coat-tail provisions") should be included in the shares' attributes.

The Commission is of the view that the issuance of restricted shares without protective or coat-tail provisions is contrary to legislative policy and adopts the following excerpt from the OSC Staff Submission prepared for the 1981 OSC hearing on restricted shares:

'...it is clear from legislative history that the Securities Act was intended by the Legislature to regulate measures designed to usurp to a restricted group premiums for the sale of control. The Act permits an offeror to acquire control by way of a private agreement to purchase voting securities at a premium above the market price but requires such an offeror to make an equivalent follow-up offer to the remaining holders of voting securities within 180 days of the private agreement.

Obviously, as no bid need be made to holders of restricted residual equity securities and no follow-up offer is required to be made to them by law, controlling shareholders may have, despite the intention in Part XIX of the Securities Act, found a means to retain to themselves the premium for control."

Policy 1.3 is, therefore, being amended to provide that no receipt will be issued for any prospectus offering shares of any class or series of restricted shares, and that statutory exemptions will be denied in connection with any offering of such shares by way of a rights offering, securities exchange take-over bid, reorganization or amalgamation, unless the shares include protective provisions in their attributes. The proposal does not, for the time being, extend to denying prospectus exemptions to other distributions of restricted shares without coat-tail provisions where such distributions do not involve a wide public distribution of additional shares (e.g., private placements). The Commission would welcome comments on whether all prospectus exemptions should be denied.

For the purpose of the amended Policy 1.3 "protective or coat-tail provisions" will mean that the attributes of the shares are such that the holders of restricted shares will have an opportunity to participate in any take-over bid or other change in control on the same terms (or comparable terms, having regard to their respective equity interests). Generally this will mean that when a take-over

bid is made for the common shares of a reporting issuer and a corresponding general offer is not made, the restricted shares would participate in the take-over bid for the common shares through a right to convert into common shares. "Corresponding general offer" means an offer for the restricted shares where the offeror offers to purchase the same percentage of shares at the same consideration per share as is offered for the common shares. It would not be sufficient, as a protective provision, to grant voting rights to the holders of non-voting shares or to grant a right of conversion into common shares where there is no opportunity to participate in the take-over bid for the common shares or other change in control transaction.

Adoption of this Policy would mean that the Commission would not be directly mandating the inclusion of such provisions in the attributes of existing classes or series of restricted shares although it might indirectly encourage this result over time.

Although issuers would not be required to amend the terms of existing classes of restrictedshares they would, in effect, not be permitted to carry out a major public distribution of additional shares of the restricted share class unless protective provisions were added. An issuer with restricted shares that wanted to issue additional residual equity shares could:

(i) issue common shares,

(ii) issue shares of a new class of restricted shares with protective provisions, or

(iii) amend the terms of the existing class of restricted shares. and issue shares of that class.

The Commission recognizes that defining acceptable terms for protective provisions will require considerable work and experience. Its corporate finance staff will provide assistance to issuers in developing suitable protective provisions.

The Commission considers the foregoing policy to be appropriate because restricted shares represent equity ownership and, as a matter of fairness, investor confidence and legislative policy, the holders of such shares should have an opportunity to participate in any premium control transaction. It would be harmful to the credibility of the public share ownership system for control to change hands at a premium under a sale of one class of residual equity shares, most or all of which would probably be held by a restricted group, if no comparable bid were made for publicly-distributed residual equity shares with lesser or no voting rights.

B. Minority Approval of Capital Reorganizations

The creation and distribution of a class of restricted shares may be, and is often perceived by investors to be, carried out for the benefit of a controlling shareholder with no corresponding benefit for other shareholders. The existence of a publicly-traded class restricted shares allows a controlling shareholder to consolidate control and avoid dilution in a number of ways. For example:

(i) the financing needs of the issuer can be met through the issuance of restricted shares without the controlling shareholder having to subscribe for such shares to avoid dilution in its voting control;

(ii) the controlling shareholder can dispose of non-voting shares acquired in a reorganization to finance past or future acquisitions of voting shares; and

(iii) if the attributes of restricted shares' include a preferential right to dividends, and the common shares are convertible into the restricted shares, the public will over time come to hold fewer voting shares and more restricted shares, thereby consolidating the position of the controlling shareholder.

It can be argued that after a share reorganization or share split to create restricted shares, the public shareholder is technically in the same position as the controlling shareholder in that they each hold the same relative numbers of common and restricted shares and therefore there is no benefit to the controlling shareholder or detriment to minority shareholders to justify a requirement for minority approval. The Commission rejects this argument. The share split creates opportunities for the control person, i.e., to finance, consolidate or prevent dilution of control at a reduced cost, that are not available to other shareholders.

To require minority approval is an attempt to redress the unequal bargaining positions of controlling shareholders and public investors in a transaction where the controlling shareholder is perceived to obtain a benefit not available to other shareholders. The unequal bargaining positions stem largely from the controlling shareholders' ability to control, through its own votes and access to the corporate proxy machinery, the outcome of the vote on the proposed reorganization or amalgamation. Minority approval would introduce a "market test" that would allow those shareholders who may not obtain an economic benefit from the reorganization, amalgamation or other distribution to balance the various benefits that *may* accrue to different groups of shareholders within a single class.

The Commission is of the view that the creation and distribution of restricted shares should not proceed without the approval of the minority shareholders. Therefore, minority approval will be required for:

(i) a reorganization or amalgamation that would have the effect of converting common shares into restricted shares,

(ii) a stock dividend of restricted shares (other than a stock dividend in the ordinary course in lieu of a cash dividend) equivalent in effect to share reclassification, and

(iii) any other analogous form of distribution of restricted shares.

If minority approval is not obtained for such transactions, the applicable prospectus exemptions will be denied.

"Minority approval" will have a meaning similar to that which it has in the Ontario Business Corporations Act and Policy 9.1 -- Going Private Transactions, Issuer Bids and Insider Bids:

> "Minority approval" would mean the votes of security holders cast in favour of a transaction other than the votes attaching to:
>
> (a) securities held by affiliates of the issuer; and
>
> (b) securities the beneficial owners of which, alone or in concert with others, effectively control or will control the issuer.

C. Voluntary Offers for Non-Voting Shares

The rules relating to take-over bids set out in Part XIX of the Act apply only to offers for voting securities. Therefore, a purchaser of non-voting shares would be free to purchase 100% of a class of non-voting shares on the open market without disclosure to the holders of such securities, without time restraints and in the absence of the other procedural and substantive protections provided by Part XIX (such as withdrawal rights and the requirement that the same consideration be offered to all shareholders of the same class). The Commission considers that the "protection of the bona fide interests of the shareholders of the offeree company", the primary objective of the take-over bid code, is a concern regardless of whether the securities that are the subject of the bid are voting or non-voting. Accordingly, the Commission will exercise its powers to require persons or companies making a bid for non-voting shares, to conduct the bid as though it was subject to Part XIX of the Act. The Commission is

in the process of preparing amendments to the Act to ensure that the take-over bid framework will apply to voluntary purchases of non-voting shares in excess of the 20% threshold.

D. Amendments to Existing Policy 1.3

While the foregoing comprise the major changes being made to Policy 1.3, the draft Policy will also include some amendments to the existing disclosure requirements. Certain of the amendments are aimed at making the disclosure regime more effective while others are intended to deal with problems and ambiguities that have cropped up in the application of the existing Policy. In addition, provisions that are no longer applicable have been deleted. The significant changes will be described in the commentary accompanying the forthcoming Policy.

V. EFFECTIVE DATE

The additions to the Policy Statement set out in sections IV.A to IV.0 above are effective immediately on an interim basis. The amendments to the existing disclosure requirements of the Policy referred to in IV.D above are not effective until the Policy is finalized. "Interim basis" refers to the period from March 2, 1984 until publication of the final form of Policy Statement which will reflect public comment and the decision of the Commission to continue, vary or abandon any or all of the additions.

The portion of the Policy that is to be effective immediately on an interim basis would not apply to work in process as of the effective date of March 2, 1984. A matter will be considered to be "work in process" where an offering or other document has been filed or mailed to shareholders prior to the effective date. In respect of a preliminary prospectus for restricted shares, the document would be considered "work in process" when a receipt has been issued prior to March 2, 1984. The Director is available to discuss with interested persons the application of the interim Policy to particular situations.

VI OTHER PROVINCES

These proposals have been discussed with the QSC and the B.C. Superintendent - the securities administrators for the provinces that have policies similar to the current Policy 1.3. The Commisson has been advised by the QSC and the B.C. Superintendent that they support the position of the Ontario Securities Commission and will implement similar requirements for protective provisions, minority approval and application of the take-over bid framework to purchases of non-voting shares. The QSC and the B.C. Superintendent will also consider the necessity of amending the disclosure requirements set out in their respective policies on restricted shares.-

VII REQUEST FOR COMMENTS

As referred to earlier, the proliferation of the use of restricted shares raises many issues both within and beyond the jurisdiction of the Commission. The Commission is anxious to receive the comments of all interested parties relating to all issues. No decision has been made as to the necessity of holding a public hearing on these issues.

Comments are requested, in particular, on:

(i) the issues and concerns raised by the proliferation of restricted shares, including those issues raised in this paper;

(ii) the appropriate jurisdiction and course of action for resolving the is-s-ue-s raised;

(iii) the specific additions and amendments to Policy 1.3; and

(iv) the need for other or further steps to be'taken by the Commission or others to regulate the use of restricted shares.

The Commission requests that all interested parties forward 10 copies of their comments on or before April 13, 1984 to:

The Secretary
Ontario Securities Commission
Suite 1800
Box 55
20 Queen Street West
Toronto, Ontario
M5H 3S8

Copies should also be provided to:

(a) President
Commission des valeurs mobilieres du Quebec
P.O. Box 246
Stock Exchange Tower
800 Victoria Square
Montreal, Quebec
H4A 1G3

(b) The Superintendent of Brokers, Insurance and Real Estate
Ministry of Consumer and Corporate Affairs
865 Hornby Street
Vancouver, British Columbia
V 6Z 1H4

The Commission undertakes to provide copies of comments to any other securities administrator that expresses an interest in the regulation of restricted shares.

March 2, 1984