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OSC CASE CLARIFIES WHEN TO DISCLOSE PROPOSED M&A TRANSACTION

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M&A specialists are breathing a partial sigh of relief at the decision released by the Ontario Securities Commission earlier this week which considered whether a public company could be required to announce a merger transaction before the signing of a definitive binding agreement. While the Commission's decision does not provide a "bright-line" test or make it a simple task to determine when a merger should be disclosed in the future, it provides welcome clarification to an important disclosure obligation on which there has been uncertainty and little guidance in the past.

In a nutshell, the decision states that if there is "sufficient commitment" from the parties to proceed with a merger and there is a "substantial likelihood" that the merger would be completed, an obligation to disclose may be triggered. The determination of whether a material change has occurred will have to be examined on a case by case basis depending on the specific facts and circumstances.

Will public companies now revert to the old practice of disclosing a merger once a definitive binding agreement is entered into? Perhaps, but companies now have a rational and common sense analytical tool with which they can make the decision as to when it is appropriate to disclose a merger transaction. In some cases, the time to disclose will arise sooner, but companies are not being compelled to disclose prematurely.

The decision dealt in particular with two events that occurred during the 2002 acquisition by 3M Company of AiT Advanced Information Technologies Corporation, a company based in Ottawa with a relatively small market capitalization then listed on the TSX. The Commission examined whether resolutions adopted by AiT's board about a month before the definitive agreement was signed was a material change that should have been the subject of a news release and material change report filed with securities regulators. The Commission also examined whether the signing of a non-binding letter of intent by the parties also about a month before the signing of the definitive agreement was a material change.

Briefly, the definition of a "material change" in the Securities Act of Ontario is a change in the "business, operations or capital" of a company that would reasonably be expected to have a significant effect on the market price or value of securities of the company and includes a "decision to implement" such a change made by the board or senior management who believe that board approval is probable. Once a material change has occurred, a legal obligation arises to disclose the material change by issuing a news release and filing a material change report.

The AiT decision provides clarification as to when board approval in an arm's length merger transaction, before a definitive agreement has been reached, is a "decision to implement" a material change, triggering an obligation to disclose the merger transaction. According to the AiT decision, 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." A decision by a board to pursue a potential transaction that is not yet within its control to put into effect would not ordinarily be a material change unless the board has reason to believe that the other party is also committed to completing the transaction. The Commission also decided that in the facts and circumstances of the AiT case, the entering into of a letter of intent did not constitute a material change in the business, operations or capital of AiT.

The Commission decided that there was no clear and cogent evidence in the AiT case that a material change had occurred in the business, operations or capital of AiT during the period examined. The allegations against Deborah Weinstein, a director of AiT and its lawyer (that she had authorized, permitted or acquiesced in a breach of Ontario securities laws and engaged in conduct contrary to the public interest) were therefore dismissed.

Because the decision of the Commission is fact-driven, it is important to understand the chronology of events. By way of background, Ms. Weinstein was one of eight directors of AiT, which specialized in the sale of systems to issue and inspect secure travel documents. The Commission's February 2007 notice of hearing was issued only against AiT, Bernard Jude Ashe (CEO and a director) and Ms. Weinstein and not against any of the other directors of AiT. AiT and Ashe settled with the Commission earlier in the year.

In September 2001, AiT had approximately 110 employees and annual revenues in the range of \$16-\$17 million. After meetings with customers revealed that AiT had to get bigger in order to be able to bid on some of the opportunities that would come up in the future, and after an attempt at completing an equity financing in late 2001 failed, AiT's board made a decision to engage a financial advisor to investigate strategic opportunities.

AiT and 3M entered into a non-disclosure agreement specifically relating to a potential transaction in March 2002. Pricing discussions began in mid-April. On April 24, 3M representatives suggested a price of \$41 million for all of the common shares of AiT (\$2.88 per share).

AiT's board met on April 25, 2002. Commission staff focused on the minutes of this board meeting which stated that the 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”, subject to confirmation of the fairness of this price by its financial advisors and the board being satisfied with the final terms of the transaction.

On April 26, 2002, the parties signed a “non-binding” letter of intent with respect to 3M’s offer to acquire all of the common shares of AiT at a price of \$2.88 per share. The offer as detailed in the letter of intent was subject to, among other things, a due diligence review by 3M, which was to be completed by May 13, execution of support agreements by certain shareholders to vote in favour of the transaction and the approval of the appropriate management committees and the board of directors of 3M.

On May 9, 2002, AiT received a telephone call from staff of Market Regulation Services Inc., the regulator of TSX trading, regarding an unusual increase in the trading volume and price of AiT shares. AiT issued a news release that the company was “exploring strategic alternatives that would ultimately enhance value for our shareholders.” The news release made no mention of a possible transaction with 3M.

On May 14, 2002, the 3M board approved the merger transaction, subject to a few conditions which were subsequently satisfied by May 21. On May 22, AiT’s board received a favourable fairness opinion and approved the definitive merger agreement, which AiT and 3M signed the next day. Shareholders holding approximately 39% of AIT common shares signed support agreements agreeing to vote in favour of the transaction. On the day of signing, AiT issued a news release and subsequently filed a material change report announcing that it had entered into the definitive merger agreement.

The Commission reviewed the distinction between a “material fact” and “material change” under the Securities Act and noted that while the provisions of the Act relating to insider trading prohibit the buying and selling of securities with knowledge of a material fact as well as a

material change, the timely disclosure legislation only requires a company to issue a news release and file a material change report when there has been a material change.

Despite the wording of the minutes for the AiT board meeting held on April 25, 2002, the Commission concluded that the purpose of the meeting was to obtain the board's support for 3M's valuation of AiT as a precursor to 3M proceeding with its in-depth process and expending resources to continue the negotiations, and that the negotiations were at a preliminary stage. The evidence revealed that the minutes for the April 25 meeting had not been prepared until some time in June or July 2002. The Commission concluded after reviewing the evidence that the minutes of the April 25 meeting did not accurately reflect the AiT board's discussions and that the resolutions passed on that day were not intended by the board to be a "decision to implement" a material change.

As for the letter of intent, the Commission stated that disclosure obligations do not automatically arise upon the signing of a letter of intent. The Commission found that the AiT letter of intent was non-binding and did not contain any commitment on the part of 3M to complete the acquisition. Further, the Commission determined that the proposed price of \$2.88 per share was not a firm commitment and was subject to renegotiation downwards if 3M's due diligence review identified problems, or if AiT's financial condition worsened.

While it was clear to the Commission that AiT's board believed 3M's proposed price was fair and that AiT's board would support the completion of a transaction at that price, the Commission was unable to conclude from the evidence that 3M was also committed to the transaction at the letter of intent stage.

The Commission agreed with its staff that in certain circumstances it might well be appropriate to conclude that a material change has occurred at the letter of intent stage and that in that case a company should make disclosure, based on a determination of the level of commitment of the

parties to complete the transaction and the likelihood of completion. As an example of a situation when disclosure may be appropriate, the Commission referred to a situation in which the buyer might be smaller and less process-driven, and where the negotiations are led by the buyer's CEO and within the CEO's scope of authority. In the AiT case, the main 3M contact person for AiT was in middle management, and the directors and officers of AiT were not certain that the transaction would in fact be approved by the higher authorities at 3M.

There is no question that premature disclosure can put a prospective deal at risk by driving up the price of shares, creating issues with customers and employees and causing turmoil in the market, particularly if a disclosed transaction is not completed. The Commission's decision in AiT is helpful clarification of legislation which was difficult to apply in the context of merger negotiations. Public companies now have a tool with which they can make an appropriate decision as to when to disclose.

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