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February 8, 2009

Delivered and sent by e-mail

Mr. John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West, Suite 1903, Box 55
Toronto, ON M5H 3S8

Dear Mr. Stevenson:

Re: Response to the application by Rusoro Mining Ltd. ("Rusoro") for relief under Section 127 of the *Securities Act* (Ontario) (the "Act") to cease trade the Shareholder Rights Plan of Gold Reserve Inc. ("Gold Reserve") (the "Response")

- and -

Application by Gold Reserve for relief under section 127 of the Act (together with the Response, the "Application") to cease trade Rusoro's share exchange offer to purchase all of the issued and outstanding Class "A" common shares and equity units of Gold Reserve (the "Rusoro Exchange Offer")

We refer to the Gold Reserve Application dated February 6, 2009 addressed to the Ontario Securities Commission (the "Commission"). Capitalized terms used but not otherwise defined in this letter have the meanings given to them in the Application.

On behalf of Gold Reserve, we hereby submit to the Commission the following supplemental legal analysis to the Application.

LEGAL ANALYSIS

Section 127(1) of the Act provides the Commission with the jurisdiction to intervene in activities related to the Ontario capital markets when it is in the public interest to do so. The legislature clearly intended that the Commission have a very wide discretion in such

matters. The permissive language of s. 127(1) expresses an intent to leave it for the Commission to determine whether and how to intervene in a particular case.[1]

> **127.** (1) 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 . . . . [Emphasis added.]

The breadth of the Commission's discretion to act in the public interest is also evident in the range and potential seriousness of the sanctions it can impose under s. 127(1). Furthermore, pursuant to s. 127(2), the Commission has an unrestricted discretion to attach terms and conditions to any order made under s. 127(1).[2]

> **127.** (2) An order under this section may be subject to such terms and conditions as the Commission may impose.

Section 127 grants the Commission jurisdiction to exercise its discretion to cease trade the taking up of shares on a take-over bid, either on a temporary or permanent basis.

> **127.** (1) 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:
>
> ...
>
> 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.
>
> 2.1 An order that acquisition of any securities by a particular person or company is prohibited, permanently or for the period specified in the order.

The Commission need not find there has been a violation of securities laws in order to exercise its powers to make an order under section 127 of the Act.[3]

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[1] *Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, 2001 SCC 37, [2001] 2 S.C.R. 132 at paragraph 38.

[2] *Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, 2001 SCC 37, [2001] 2 S.C.R. 132 at paragraph 39.

[3] *Re Canadian Tire Corp.* (1987), 10 O.S.C.B. 857, aff'd (1987), 59 O.R. (2d) 79, leave to appeal to C.A. denied (1987), 35 B.L.R. xx; *Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, 2001 SCC 37, [2001] 2 S.C.R. 132 at paragraph 42.

In particular, the Commission may find it abusive for the offeror of a takeover bid to engage in conduct designed to avoid the animating spirit of takeover legislation, or other securities laws designed to safeguard the purposes set out in section 2.1 of the Act. Motive is therefore a relevant consideration.[4]

Section 1.1 Purposes

The Commission's exercise of jurisdiction under section 127 is to be animated by both of the purposes declared in section 1.1 of the Act.[5]

> 1.1 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.

Gold Reserve seeks an order of the Commission to cease trade Rusoro's bid to promote both these purposes.

A central aspect of Gold Reserve's complaint is that it would be unfair to Gold Reserve's shareholders to allow Rusoro to acquire shares with the benefit of results from Rusoro drilling illegally on Gold Reserve's property, without having disclosed credible results to Gold Reserve and having undermined the means for subsequent credible verification. An order of the Commission is required to protect Gold Reserve investors from selling below full value due to the unfair or improper actions of Rusoro.

In this respect, the Commission should be mindful of the fundamental principle that one of the primary means of achieving the purposes in section 1.1 of the Act is to require the maintenance of high standards of business conduct to ensure honest and responsible conduct by market participants and timely and accurate disclosure of information.

> **2.1** In pursuing the purposes of this Act, the Commission shall have regard to the following fundamental principles:
>
> ...

[4] *Re Canadian Tire Corp.* (1987), 10 O.S.C.B. 857, aff'd (1987), 59 O.R. (2d) 79, leave to appeal to C.A. denied (1987), 35 B.L.R. xx; *Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, 2001 SCC 37, [2001] 2 S.C.R. 132 at paragraph 52-55.

[5] *Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, 2001 SCC 37, [2001] 2 S.C.R. 132 at paragraph 41.

2. The primary means for achieving the purposes of this Act are,

i. requirements for timely, accurate and efficient disclosure of information,

ii. restrictions on fraudulent and unfair market practices and procedures, and

iii. requirements for the maintenance of high standards of fitness and business conduct to ensure honest and responsible conduct by market participants.

3. Effective and responsive securities regulation requires timely, open and efficient administration and enforcement of this Act by the Commission.

Concerning the second purpose listed in section 1.1 of the Act, the promotion of bidder auctions in a takeover context conducted on a level playing field fosters fair and efficient capital markets and confidence in capital markets. This also ultimately benefits shareholders of the target company, consistent with the first listed purpose in section 1.1 of the Act.

Where potential bidders perceive that an existing bid may be premised on non-public information as to the value of the target reporting issuer that the rival bidder could not credibly replicate through due diligence arrangements with the target company, market confidence is undermined. It is unfair to Gold Reserve shareholders that Rusoro might gain the benefit of an auction advantage created and perpetuated by its own illegal and improper conduct, to the detriment of Gold Reserve shareholders.

It would therefore be consistent with the purposes listed in section 1.1 of the Act for the Commission to intervene by making an order under section 127 to maintain confidence in the capital markets.

Material Disclosure

One of the central animating purposes in a takeover bid context is disclosure of material facts and a prohibition on trading with knowledge of undisclosed material facts by certain market participants or derived from those participants. There are provisions of the Act designed to address trading based on material undisclosed information within a target reporting issuer and extends to persons in a special relationship with the target reporting issuer.

> **76.** (1) 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.
>
> ...
>
> (5) 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, ...

Section 76 of the Act also addresses directly the fact a person "proposing" to make a takeover bid will possess material information, such as its undisclosed intentions to bid, to bid higher or to withdraw from a bidding process as plans are formulated, and may also possess information about the reporting issuer obtained from the reporting issuer through due diligence.

> **76.** (5) 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,

Section 76 of the Act also extends to persons who are engaged or are "proposing" to engage in financially advising either a reporting issuer or a person proposing to make a

takeover bid. This would therefore apply to Endeavour, which at the time when Rusoro proposed to make its hostile takeover bid and use Endeavour as its financial adviser for the bid:

(a) was a financial adviser for Gold Reserve,

(b) was a shareholder of Rusoro,

(c) was a significant creditor of Rusoro, and

(d) was further tied to Rusoro through Gordon Keep, who was and continues to be a director of Rusoro and a principal at Fiore Financial Corporation, which provides advisory services exclusively to Endeavour, and

(e) used the same individuals to advise Rusoro who had advised Gold Reserve.

It is reasonable to conclude that during the time period when Endeavour was acting as financial advisor to Gold Reserve it was indirectly conveying Gold Reserve's confidential information to Rusoro by advising Rusoro that by making the hostile bid for Gold Reserve it would form the leading Venezuelan gold development and growth company, and that an exchange ratio of 3 Rusoro Shares to each Gold Reserve Voting Security would be fair to *Rusoro*.[6] It is not reasonable under the circumstances to believe that Endeavour could, in making those recommendations to Rusoro, disregard its knowledge of material facts regarding Gold Reserve. Moreover, Rusoro could not have been oblivious to the inability of its Endeavour advisors to construct fire walls within their minds and rely only upon public information in connection with their recommendations.[7]

> **76.** (5) For the purposes of this section,
>
> "person or company in a special relationship with a reporting issuer" means,
>
> (a) ...
>
> (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

[6] Exhibit "C" to Belanger Affidavit, p. 2.

[7] See *MacDonald Estate v. Martin* (1990), 77 D.L.R. (4th) 249 (S.C.C.) at p. 268 (per Sopinka J.).

> reporting issuer or with or on behalf of a person or company described in subclause (a) (ii) or (iii),

Finally, section 76 extends to persons who receive information from those in a special relationship with the reporting issuer. Accordingly, Rusoro was potentially in a special relationship with Gold Reserve through its use of Endeavour, which Rusoro knew was in a special relationship with Gold Reserve.

> **76.** (5) For the purposes of this section,
>
> "person or company in a special relationship with a reporting issuer" means,
>
> (a) ...
>
> (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.

These provisions of the Act indicate the strong public interest in regulating potential imbalances of knowledge of material facts with respect to trading on the market. The importance of regulating potential information imbalance is heightened in the context of a takeover bid, where there is an element of economic coercion applied to shareholders of the target reporting issuers, who may otherwise be unwilling sellers but have to decide whether they are being presented with the best offer for them to participate in any premium offered for an effective sale of control and might lose the opportunity to realize value from the sale of control by not tendering.

The scope of the restriction on trading imposed by section 76 is regulated by the definition of material fact and material change in section 1(1) of the Act.

> "material fact", when used in relation to securities issued or proposed to be issued, means a fact that would reasonably be expected to have a significant effect on the market price or value of the securities; ("fait important")
>
> "material change",
>
> (a) when used in relation to an issuer other than an investment fund, means,

> (i) 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, or
>
> (ii) a decision to implement a change referred to in subclause (i) made by the board of directors or other persons acting in a similar capacity or by senior management of the issuer who believe that confirmation of the decision by the board of directors or such other persons acting in a similar capacity is probable, and ... ("changement important")

The meanings of material fact and material in terms of shareholder expectations and trading decisions was extensively reviewed by the trial decision in *Kerr v. Danier Leather*.[8]

In particular, the court considered the difference in wording of the test for material fact under the Act in comparison to the U.S. test. Justice Lederman quoted from *Pezim*, noting that the scope of material fact is broader than material change.[9]

> In *Pezim v. B.C. (Superintendent of Brokers)*, 1994 CanLII 103 (S.C.C.), [1994] 2 S.C.R. 557 at 597, Iacobucci J. comments on the relationship between "material fact" and "material change" as follows:
>
> > Both "material change" and "material fact" are defined in … the Act. They are defined in terms of the significance of their impact on the market price or value of the securities of an issuer. The definition of "material fact" is broader than that of "material change"; it encompasses any fact that can "reasonably be expected to significantly affect" the market price or value of the securities of an issuer, and not only changes in the "business, operation, assets or ownership of the issuer" that would reasonably be expected to have such an effect.

Justice Lederman compared the definition under the Act with the definition under U.S. securities laws as interpreted by American jurisprudence.[10]

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[8] *Kerr v. Danier Leather Inc.* (2004), 46 B.L.R. (3d) 167, 23 C.C.L.T. (3d) 77, [2004] O.J. No. 1916 (QL), 2004 CanLII 8186 (ON S.C.), reversed on another issue (2005), 77 O.R. (3d) 321, 261 D.L.R. (4th) 400, 205 O.A.C. 313, 11 B.L.R. (4th) 1, [2005] O.J. No. 5388 (QL), 2005 CanLII 46630 (ON C.A.), appeal dismissed, 2007 SCC 44, [2007] 3 S.C.R. 331.

[9] *Kerr v. Danier Leather Inc.*, supra, at paragraph 141.

[10] *Kerr v. Danier Leather Inc.*, supra, at paragraphs 168-169.

> [168] The standard of materiality under Rule 10b-5 and s. 11 of the U.S. 1933 Act differs from the standard defined in the OSA. The U.S. standard is set-out in *Trump*, *supra*, at 369 as follows (quoting from *TSC Industries Inc. v. Northway Inc.* 426 U.S. 438 (1976) at 439):
>
>> TSC instructs that "an omitted fact is material if there is a substantial likelihood that a reasonable [investor] would consider it important in deciding how to [act]."...For an omission to be deemed material, "there must be a substantial likelihood that [its disclosure] would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."
>
> [169] This standard of materiality is similar to the guidance regarding materiality provided in NP 48 discussed above.

It is submitted that for the purposes of this matter, the Commission ought not to seek to draw fine distinctions between the wording of the definition of material fact in the Act and the U.S. test. This is especially so in the context of a takeover bid being conducted both in Canada and, under the Multijurisdictional Disclosure System, the United States and where the Commission is in essence acting as regulator for both jurisdictions. In this regard, the Supreme Court of Canada in *Asbestos* observed that coordination with other securities jurisdictions is an important consideration for the Commission when exercising its discretion to make orders in the public interest under section 127 of the Act.

> 62 It is true that the OSC placed significant emphasis on the transactional connection factor. However, it was entitled to do so in order to avoid using the open-ended nature of s. 127 powers as a means to police too broadly out-of-province transactions. Capital markets and securities transactions are becoming increasingly international: see *Global Securities Corp. v. British Columbia (Securities Commission)*, [2000] 1 S.C.R. 494, 2000 SCC 21, at paras. 27-28. There are a myriad of overlapping regulatory jurisdictions governing securities transactions. Under s. 2.1, para. 5 of the Act, one of the fundamental principles that the OSC has to consider is that "[t]he integration of capital markets is supported and promoted by the sound and responsible harmonization and coordination of securities regulation regimes". A transaction that is contrary to the policy of the Ontario Securities Act may be acceptable under another regulatory regime. Thus, the OSC's insistence on a more clear and direct connection with Ontario in this case reflects a sound and responsible approach to long-arm regulation and the potential for conflict

> amongst the different regulatory regimes that govern the capital markets in the global economy.[11]

Further, in exercising jurisdiction under section 127, the Commission is not to take an overly technical approach to interpreting the Act.

> [43] The defendants contend that the OSA and NP 48, when read together indicate that forecasts are not facts. Subsection 56(1) of the OSA requires all material facts to be included in the prospectus. The OSA does not address forecasts, but under Part 1 of NP 48, the inclusion of forecasts is optional. Therefore, the defendants submit, forecasts cannot be material facts because all material facts are required to be stated and forecasts are not required to be stated.
>
> ...
>
> [45] The defendants' interpretation requires a narrow reading of the OSA. In *Re C.T.C. Dealer Holdings Ltd. et al.* (1987), 37 D.L.R. (4th) 94 at 119 (Ont. Div. Ct.), the Ontario Divisional Court indicated that the OSA should not be interpreted in a technical manner; rather, the OSA should be interpreted in accordance with the fundamental purposes of securities law. Section 1.1 of the OSA sets out its purposes:
>
> > 1.1 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.
>
> See also *Pearson v. Boliden* 2002 BCCA 624 (CanLII), (2002), 222 D.L.R. (4th) 453 at para. 62 (B.C.C.A.); *Pezim v. British Columbia (Superintendent of Brokers)*, 1994 CanLII 103 (S.C.C.), [1994] 2 S.C.R. 557 at 600.
>
> [46] The defendants' interpretation is contrary to the stated purposes of the OSA. ...[12]

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[11] *Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, 2001 SCC 37, [2001] 2 S.C.R. 132 at paragraph 62.

[12] *Kerr v. Danier Leather Inc.*, supra, at paragraphs 43-46.

It follows from the foregoing legal analysis that the Commission should consider whether disclosure of credible drilling results to verify what information Rusoro obtained through trespass on Gold Reserves lands is the type of information (1) that might reasonably be expected to have a significant effect on the market price or value of Gold Reserve shares, (2) in respect of which there is a substantial likelihood that a reasonable Gold Reserve shareholder would consider this type of information important in deciding whether to tender to the take-over bid or support management efforts to establish an auction; or (3) in respect of which there is a substantial likelihood that disclosure of credible drilling results would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.

Gold Reserve submits that the results of drilling to ascertain whether Choco 5 contains economic quantities of gold is information that would plainly be the type of information Gold Reserve shareholders would consider important in the total mix of information when decided whether or not to tender into the Rusoro takeover bid.

It cannot be established at this time whether or not the drilling results obtained by Rusoro constitute undisclosed material facts known to Rusoro that would prohibit it from trading in the securities of Gold Reserve by operation of section 76 of the Act. Consistent with the jurisprudence in *C.T.C. Dealers Association*, as recognized by the Supreme Court of Canada in *Asbestos*, the Commission in exercising jurisdiction under section 127 should consider the conduct of Rusoro and whether it has the effect of undermining the animating spirit of section 76 and takeover regulation generally.

It is abusive of section 76 and the purposes of the Act for Rusoro to trade on undisclosed drilling information that it obtained unlawfully and conducted in a manner that does not allow credible verification of results by Gold Reserve or some other suitable representative of Gold Reserve shareholders. Rusoro cannot be allowed to ask Gold Reserve shareholders to trust its representations as to the nature of the results when Rusoro's entire course of conduct demonstrates it cannot be trusted in this regard.

Overall Context

The Commission is to exercise its discretion taking into account all relevant factors.[13]

Rusoro's theft of drilling information that cannot now be verified by reason of Rusoro's conduct (short of Gold Reserve duplicating the drilling), was not an isolated event. It occurred within the context of a pattern of otherwise questionable conduct by Rusoro.

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[13] *Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, 2001 SCC 37, [2001] 2 S.C.R. 132 at paragraph 56.

In particular, Rusoro chose to use Endeavour as its financial adviser for the hostile takeover bid at a time when Endeavour was also retained as financial adviser to Gold Reserve and had for many years been active in debt financing modeling and strategic planning for Gold Reserve. As deposed by Stanley Beck, such conduct is unprecedented in Canadian capital markets. It augments the auction chill raised by the illicit drilling activity, tending to raise additional doubts for would-be auction participants.

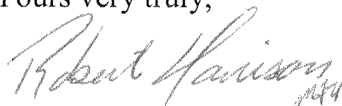
As reflected in Exhibit "C" to the affidavit of Douglas Belanger, on December 10, 2008, Endeavour made a presentation to Rusoro in which it recommended a hostile bid at a 3:1 share exchange ratio. The presentation identified the potential importance of Gold Reserve's Choco 5 property and made the following peculiar comment: "Allowing [Gold Reserve] to be sold to another suitor will decrease [Rusoro]'s status with the Venezuelan government as 'most preferred partner'".

It is submitted that, in all of the circumstances, intervention by the Commission is warranted and that to permit Rusoro's takeover bid to proceed would grant a license to bidders to engage in conduct that materially undermines the integrity of the capital markets and would be seen as an extremely poor reflection on the quality of the Canadian securities regulatory regime.

PROCEDURAL MATTERS

We enclose herewith 10 additional copies of this supplemental submission for the members of the Hearing Panel. Should you have any questions or comments regarding this application, please contact the undersigned.

Yours very truly,



Robert S. Harrison

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