IN THE MATTER OF THE SECURITIES ACT
R.S.O. 1990, c. S.5, AS AMENDED

- AND –

IN THE MATTER OF
SEARS CANADA INC.,
SEARS HOLDINGS CORPORATION,
AND SHLD ACQUISITION CORP.

- AND –

IN THE MATTER OF
HAWKEYE CAPITAL MANAGEMENT, LLC,
KNOTT PARTNERS MANAGEMENT, LLC, and
PERSHING SQUARE CAPITAL MANAGEMENT, L.P.

REASONS AND DECISION

Hearing	-	July 4 - 6, 2006

Panel

Susan Wolburgh Jenah	-	Vice-Chair (Chair of the Panel)
Robert W. Davis, FCA	-	Commissioner
Carol S. Perry	-	Commissioner

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Scotia Capital Inc.	-	Gary Girvan
	-	Thomas Sutton
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For The Royal Bank of Canada	-	Peter Howard
	-	Mihkel Voore
For William Anderson	-	Gerald Ranking

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REASONS AND DECISION

I. Overview

A. Background to the Proceeding

[1] Two Applications were filed in relation to an offer of SHLD Acquisition Corp. (SHLD), a wholly-owned subsidiary of Sears Holdings Corporation to acquire all of the outstanding common shares of Sears Canada Inc. (Sears Canada) not owned by it or its affiliates (the "Offer"). The Offer was announced on December 5, 2005, formally commenced on February 9, 2006 and expires on August 31, 2006.

[2] In conjunction with the Offer, Sears Holdings informed the shareholders of Sears Canada of its intention to take Sears Canada private following the completion of the Offer pursuant to a second step subsequent acquisition transaction (SAT), for which "majority of the minority" approval would be required under Ontario Securities Commission Rule 61-501 - *Insider Bids, Issuers Bids, Business Combinations and Related Party Transactions* (2004), 27 O.S.C.B. 5975 ("Rule 61-501"). Sears Holdings intends to complete the SAT in December 2006.

[3] On April 6, 2006, Sears Holdings announced that it had entered into agreements with holders of a sufficient number of Sears Canada shares to assure that any SAT undertaken by Sears Holdings would be approved by a majority of the minority of the shareholders of Sears Canada.

[4] On June 5, 2006, SHLD and Sears Holdings Corporation (collectively, Sears Holdings) filed an application for relief (the Sears Holdings Application) under sections 104 and 127 of the *Securities Act*, R.S.O. 1990, c. S.5 (the Act) in respect of the conduct of Pershing Square Capital Management L.P. (Pershing), Hawkeye Capital Management, LLC (Hawkeye) and Knott Partners Management LLC (Knott) (collectively, the Pershing Group) in connection with the Offer. The fundamental allegation against the Pershing Group is that they engaged in joint activity in a coordinated effort to thwart the Offer and to frustrate the expressed will of the majority of the minority shareholders of

Sears Canada. They allege numerous breaches of Ontario securities law and seek relief from the Commission against Pershing and the Pershing Group under sections 127 and 104 of the Act.

[5] On June 5, 2006, the Pershing Group filed an application for relief against Sears Holdings (the Pershing Application) under sections 104 and 127 of the Act. They allege that various aspects of the conduct of Sears Holdings in pursuing its Offer violated Ontario securities law and constituted abusive and coercive conduct. The Pershing Group therefore requests that the Commission exercise its public interest jurisdiction and make an order under sections 127 and 104 of the Act.

[6] The Commission issued a Notice of Hearing pursuant to subsection 104(1) and section 127 of the Act on May 17, 2006, scheduling a hearing commencing on Wednesday July 5, 2006 to consider the above-noted Applications. An Amended Notice of Hearing was issued on June 7, 2006 setting down the hearing for July 4, 2006.

[7] Although The Bank of Nova Scotia (BNS), Scotia Capital Inc. (Scotia Capital) and The Royal Bank of Canada (RBC) are not named as parties to the Pershing Application, certain issues have been raised by the Pershing Group which relate to and could impact on BNS, Scotia Capital and RBC. Accordingly, we granted full standing to BNS, Scotia Capital and RBC on the consent of all the parties and subject to the conditions set out in our Orders.

[8] Prior to the hearing, we also heard and determined several motions for production of documents made by the parties. Most of these motions were heard and determined by the Chair of the panel at the request and with the consent of the parties. These motions resulted in several orders for pre-hearing production. We also made an order compelling William Anderson to testify at the hearing on the merits.

B. The Parties

[9] Sears Holdings Corporation is the United States' third largest broadline retailer with annual revenues in excess of $55 billion. It is the leading home appliance retailer as well as a leader in

tools, garden, electronics, home and automotive repair and maintenance. Prior to the announcement of the Offer, Sears Holdings held 57,732,517 common shares of Sears Canada (approximately 53.8 percent of the outstanding common shares). It is therefore an insider within the meaning of Rule 61-501.

[10] SHLD is a wholly-owned subsidiary of Sears Holdings Corporation. SHLD was incorporated for the sole purpose of making the Offer.

[11] Pershing is a New York based registered investment advisor to several investment funds (the Pershing Funds) with total capital of more than U.S. $1.8 billion. William Ackman is the founder and principal of Pershing. Pershing manages capital on behalf of more than 200 individuals, pension funds, charitable organizations, educational endowments and other institutional and corporate investors. Pershing began investing in Sears Canada in February 2005 based on its belief that Sears Canada was undervalued. In their written submissions, the Pershing Group stated that the Pershing Funds owned 5,601,400 Sears Canada shares (approximately 5.2 percent of the outstanding shares). The Pershing Funds are also entitled to the economic benefit of an additional 6,900,000 Sears Canada shares (approximately 6.4 percent of the outstanding shares of Sears Canada) under cash-settled derivatives transactions with a resulting total economic interest equal to approximately 11.6 percent of the outstanding shares of Sears Canada.

[12] Hawkeye was founded in November 1999 and is a provider of investment management services in New York. Hawkeye's activities are focused on researching and investing in equity and debt securities on behalf of Hawkeye Capital L.P.'s limited partners. The written submissions indicate that Hawkeye owned or controlled 1,525,872 Sears Canada shares (approximately 1.42 percent of the outstanding shares of Sears Canada).

[13] Knott is a New York limited liability company. Knott provides discretionary investment advisory services which include managing and directing the investment of assets for individuals, institutional clients and private investment limited partnerships. The written submissions indicate that Knott owned or controlled 1,114,300 Sears Canada shares (approximately 1.04 percent of the

outstanding shares of Sears Canada). In addition to trading in the shares of Sears Canada for its own account, Knott trades shares in Sears Canada on behalf of a number of investment funds.

C. The Applications

[14] The relevant events leading up to both the Sears Holdings and the Pershing Group's Applications being filed with the Commission are as follows.

Events Prior to the Announcement of the Offer

[15] Sears Holdings Corporation was formed as a result of the merger between Sears, Roebuck and Co. and Kmart Holdings Corporation on March 24, 2005.

[16] On June 13, 2005, Sears Canada announced it would consider strategic alternatives for its credit and financial services business.

[17] On August 31, 2005, Sears Canada announced an agreement with J.P. Morgan Chase & Co. to sell its credit and financial services business for approximately $2.2 billion in cash proceeds and stated that it proposed to make a substantial cash distribution from the proceeds of the sale to the shareholders of Sears Canada.

[18] The same day, the Institutional Equity Group at Scotia Capital purchased 125,000 Sears Canada. From August 31 to December 16, 2005, Scotia Capital Institutional Equity Group made further purchases of Sears Canada shares for an aggregate of 513,000 shares.

[19] On September 14, 2005, Sears Canada announced that it proposed to distribute approximately $2 billion of the proceeds of the sale of the credit card and financial services assets to its shareholders. Sears Canada's share price increased to over $30.00 per share after the announcement.

[20] Between, October 31 and November 29, 2005, Scotia Capital's Capital Markets Group purchased 4,000,000 Sears Canada shares. These shares were purchased in the market through trades effected over the facilities of the TSX. Scotia Capital's Capital Markets Group purchased these 4,000,000 Sears Canada shares to partially hedge its risk in relation to equity swap transactions it had entered into with SunTrust Capital Markets Inc. ("SunTrust") and a broker dealer. To further reduce its exposure, between November 29, 2005 and December 13, 2005, Scotia Capital's Capital Markets Group also entered into three total return swaps with Canadian institutions in relation to 2,042,100 Sears Canada shares.

[21] In November 2005, Sears Canada presented a proposal to its board of directors (code named "Project Dawn") setting out a number of cost saving initiatives for an estimated total of $301 million.

[22] On December 2, 2005, Sears Canada announced that its board of directors had declared that $4.38 per share would be paid to all shareholders of Sears Canada on December 16, 2005 as a return of capital and that a $14.26 per share dividend would also be paid on that day. The Pershing Funds are non-resident shareholders of Sears Canada for the purpose of Canadian tax laws. As a result, Pershing approached SunTrust with a view to entering into cash-settled total return swaps approximately equivalent to 5.3 million Sears Canada shares (the "2005 Pershing Swaps"). The purpose of Pershing entering into the 2005 Pershing Swaps was to minimize its exposure to Canadian withholding taxes by disposing of its Sears Canada shares prior to receiving the dividend while maintaining an economic interest in the performance of Sears Canada shares. In anticipation of entering into the 2005 Swaps, Pershing sold all of its shares of Sears Canada between October 31, 2005 and December 8, 2005. Pershing has no right to terminate the 2005 Pershing Swaps prior to their scheduled expiration in December of 2006 and has no right to obtain physical settlement of the 2005 Pershing Swaps upon termination.

[23] On December 4, 2005, Sears Holdings advised the directors of Sears Canada that it intended to make an insider bid to acquire all of the Sears Canada shares not then held by Sears Holdings for a purchase price of $16.86 per share. Sears Holdings also advised the directors of Sears Canada that it

had entered into an agreement with Natcan Investment Management Inc. ("Natcan") pursuant to which Natcan has agreed to tender 9,699,862 shares of Sears Canada to the intended Offer.

[24] On December 4, 2005, Scotia Capital, having heard of the yet to be announced bid, contacted Sears Holdings to secure a retainer as the financial advisor to Sears Holdings in connection with the Offer. Between December 4 and 16, 2005, Scotia Capital concurrently sought a retainer as the financial advisor to the Special Committee of Sears Canada (described below) but was not selected because of concerns about its lack of independence due to its banking relationship with Sears Canada. On December 16, 2005, Scotia Capital pursued its effort to secure a retainer as the financial advisor to Sears Holdings. On December 29, 2005, Scotia Capital met with representatives of Sears Holdings to make a pitch for the financial advisory mandate. The retainer was formalized in an engagement letter dated January 6, 2006 (the Engagement Letter). Under the Engagement Letter, Scotia Capital was entitled to a fee of $50,000 per month and a success fee of $400,000 if the transaction was accomplished at a price at or below the initial Offer price of $16.86 per share.

Relevant Events Relating to the Offer

[25] On December 5, 2005, Sears Holdings publicly announced its intention to make an insider bid to acquire all of the outstanding shares of Sears Canada not owned by it at a price of $16.86 per share. The announcement indicated that the insider bid would be subject to the usual condition that a majority (on a fully diluted basis) of the Sears Canada shares not owned by Sears Holdings be tendered (the Minimum Tender Condition). Sears Holdings also publicly disclosed that it had entered into a lock-up agreement with Natcan on December 3, 2005, pursuant to which Natcan had agreed to tender 9,699,862 shares, representing 9.06 percent of the outstanding shares of Sears Canada, into Sears Holdings' proposed insider bid.

[26] The next day, the board of directors of Sears Canada formed a Special Committee of its directors (the "Special Committee") which consisted of the six independent directors of Sears Canada, to supervise the preparation of a formal valuation and to review and make a recommendation to the board of directors of Sears Canada with respect to the proposed insider bid.

Mr. William Anderson (Anderson) was appointed Chair of the Special Committee. The Special Committee was authorized to retain independent legal counsel and independent financial advisors to assist it in carrying out its responsibilities. The Fasken Martineau law firm was retained on December 9, 2005. Genuity Capital Markets ("Genuity") was retained on December 15, 2005, to serve as independent valuator and financial advisor to the Special Committee. Genuity was asked to provide a formal valuation of Sears Canada and an opinion as to the fairness of the proposed Offer of Sears Holdings to the minority shareholders of Sears Canada.

[27] On January 10, 2006, Sears Holdings applied to the securities regulators in Ontario and a number of other provinces across Canada for exemptive relief from the requirement of Ontario securities law (and the analogous requirement in the other Canadian jurisdictions) to include a formal valuation of the Sears Canada shares in its Take-Over Bid Circular on the grounds that the Genuity valuation was not being prepared in a timely manner. Staff of the Commission (Commission Staff) advised Sears Holdings that it was not prepared to grant the requested relief at that time. However, Commission Staff agreed that such exemptive relief sought by Sears Holdings would be granted in the event that Genuity failed to deliver its valuation by the end of the week of February 6, 2006. Genuity delivered its formal Valuation and Inadequacy Opinion to the Special Committee on February 7, 2006 (the Genuity Valuation).

[28] On January 16, 2006, representatives of Sears Holdings met with Genuity to convey their views in relation to the Genuity Valuation. On January 25, 2006, Genuity advised the Special Committee that it anticipated reaching the conclusion that the consideration Sears Holdings proposed to offer to the minority shareholders of Sears Canada would be below the "bottom end of the range of the fair market value" of the common shares. The Special Committee arranged further meetings between Genuity and Sears Holdings in advance of Genuity finalizing its formal valuation and opinion regarding the insider bid. During these meetings, Genuity made a presentation to representatives of Sears Holdings concerning its valuation and methodologies.

[29] On February 6, 2006, Genuity met with and assured the Special Committee that it had given "fair consideration" to the issues and concerns that Sears Holdings had raised in respect of Genuity's valuation approach. On February 7, 2006, Genuity delivered its Valuation to the Special Committee

indicating that, in its opinion, the fair market value of the shares of Sears Canada was in the range of $19.00 to $22.25 per share and that the consideration under the proposed Offer of Sears Holdings was inadequate from a financial point of view. In its calculation of value, Genuity estimated costs savings of $95 million rather the $301 million in costs savings originally identified by the Sears Canada Project Dawn initiative.

[30] On February 6, 2006, Sears Holdings issued a press release announcing its intention to mail the Take-Over Bid Circular and that the Offer would not be subject to the previously announced Minimum Tender Condition.

[31] Scotia Capital entered into an agreement with Sears Holdings on February 8, 2006 to form and manage a soliciting dealer group. Under this agreement, and subject to a number of exceptions and limitations, soliciting dealers would be entitled to a fee of $0.10 per common share for each share tendered to the Offer.

[32] On February 9, 2006, following the delivery of the Genuity Valuation, Sears Holdings commenced its Offer for the shares of Sears Canada at $16.86 per share by distributing its Offer and Take-Over Bid Circular ("Circular") to the shareholders of Sears Canada. In its Circular, Sears Holdings was critical of the Genuity Valuation for "ignoring" the matters that had been brought to Genuity's attention by Sears Holdings. The insider bid was not subject to the Minimum Tender Condition. The Circular indicated that the Offer would expire on March 17, 2006 and that any SAT would be pursued within 120 days thereafter.

[33] Sears Canada distributed its Directors' Circular in relation to the insider bid on February 21, 2006. The voting members of Sears Canada's board (being the six independent directors comprising the Special Committee) recommended unanimously that the shareholders of Sears Canada reject the Offer and not tender their shares to the insider bid. They expressed the view that the Offer was opportunistically timed and exerted pressure on Sears Canada and its minority shareholders as evidenced by factors such as Sears Holdings' application for exemptive relief from the requirement to include a formal valuation of the shares of Sears Canada in its Circular as well as the absence of a Minimum Tender Condition. In support of this recommendation, the Special Committee noted

among other things, that the Offer was financially inadequate, significantly below the Genuity Valuation range and significantly below the average trading price of the shares on the Toronto Stock Exchange since the announcement of the Offer on December 5, 2005.

[34] On February 22, 2006, Sears Holdings issued a lengthy press release responding to the Directors' Circular.

[35] On February 27, 2006, Sears Canada announced that all six of the independent directors of the board of Sears Canada had given notice that they would not stand for re-election at the next annual meeting of shareholders.

[36] In late February 2006, Sears Holdings were advised by Scotia Capital that a significant number of shares of Sears Canada were potentially held by Canadian banks and had been acquired in connection with derivative trades transacted in connection with the extraordinary cash dividend paid by Sears Canada in December 2005. On February 28, 2006, Scotia Capital confirmed to Sears Holdings that based on its inquiries it estimated about 9 to 10 percent of the total shares outstanding were held by such shareholders, including 4 million shares held by BNS, 0.5 million shares held by Scotia Capital, 2 million shares held indirectly by BNS through swaps and 3 million shares held by RBC.

[37] On March 17, 2006, the initial expiration date of the Offer, Sears Holdings took up 10,161,968 Sears Canada shares of which 9,699,862 or more than 95 percent, had been deposited pursuant to the Natcan lock-up agreement. By this date, Sears Holdings owned 67,894,485 Sears Canada shares, representing 63.2 percent of the total outstanding shares.

[38] On March 20, 2006, Sears Holdings issued a Notice of Extension of its insider bid to March 31, 2006. The Notice of Extension indicated that, if "Sears Holdings does not acquire a majority of the minority of Sears Canada", it will support the elimination of what it characterized as the "recent practice" of Sears Canada of paying quarterly dividends. This message was also conveyed by Sears Holdings in a press release it issued that same day.

[39] On March 28, 2006, Sears Holdings entered into Support Agreements with each of BNS and Scotia Capital at a price of $16.86 per Sears Canada share. On the same day, Sears Holdings entered into Escrow Agreements with each of BNS and Scotia Capital for a total of 4,511,000 shares. These Escrow Agreements provide that the Support Agreements involving BNS and Scotia Capital would be held in escrow until at least a majority of the Sears Canada shares held by the minority shareholders was acquired by Sears Holdings pursuant to its insider bid or had become subject to support agreements substantially similar to the Support Agreements entered into by BNS and Scotia Capital.

[40] On March 31, 2006, Pershing sold 1,600,000 shares of Sears Canada to SunTrust and entered into another cash-settled total return swap transaction with SunTrust (the "2006 Pershing Swaps"), on substantially the same terms as the 2005 Pershing Swaps. SunTrust offered Pershing the alternative of cash or physical settlement. At the time Pershing entered into the swap it elected cash settlement. Pershing did not maintain a legal or beneficial interest in, or the power to exercise control or direction over, the voting rights in respect of the Sears Canada shares that were sold by it at the end of March.

[41] On April 1, 2006, Sears Holdings entered into a deposit agreement with Vornado (the Vornado Agreement) whereby Vornado agreed to deposit its 7,500,000 shares of Sears Canada to a revised Offer by Sears Holdings at an increased price of $18.00 per share and an extended expiry date. These shares were subsequently deposited and taken up such that Sears Holdings owned 75,441,763 (70.2 percent) of the outstanding Sears Canada shares. Pursuant to the terms of the Vornado Agreement, Sears Holdings agreed to provide Vornado with price protection until December 31, 2008 as a result of which it would pay to Vornado the highest price paid to any other shareholder of Sears Canada under its insider bid. Sears Holdings also provided a "litigation release" (the Release) to Vornado as discussed more fully below. Sears Holdings undertook to cause Sears Canada to provide the same Release in favour of Vornado.

[42] On April 3, 2006, Sears Holdings disclosed the Vornado Agreement in a press release. It also announced that it had increased its Offer to the shareholders of Sears Canada from $16.86 per share to $18.00 per share and extended its Offer to April 19, 2006. Sears Holdings further indicated that its

Offer had been amended to provide that any dividend paid by Sears Canada after the date of the Offer, including regular quarterly dividends would have to be remitted to Sears Holdings by shareholders who tender.

[43] Sears Holdings issued a Notice of Extension and Variation on April 4, 2006, which described the amendments to the Offer and extended to all shareholders of Sears Canada whose shares were acquired pursuant to the Offer the price protection that had been granted to Vornado. The Release was not referred to.

[44] On April 5, 2006, Pershing purchased 204,000 additional shares of Sears Canada, which brought its ownership to approximately 3.47 percent of the outstanding shares of Sears Canada.

[45] On April 5, 2006, Sears Holdings entered into a Support Agreement with RBC in respect of 3.1 million of the 3.9 million Sears Canada shares owned by RBC.

[46] On April 6, 2006, Sears Holdings announced that unnamed shareholders holding 7,611,000 Sears Canada shares (being the number of shares subject to the Support Agreements with BNS, Scotia Capital and RBC) had agreed to vote in favour of a SAT at $18.00 a share to be effected either as a share consolidation or plan of arrangement. Sears Holdings also stated that Sears Holdings and its affiliates "will own or have support commitments for sufficient shares to assure the necessary shareholder approval of a going private transaction of Sears Canada at the offer price of C$18.00 per share."

[47] The same day, Pershing acquired 1,868,400 additional shares of Sears Canada, increasing its interest to 5.21 percent and Hawkeye purchased 100,000 shares of Sears Canada.

[48] On April 7, 2006, Pershing issued a press release regarding its ownership of Sears Canada shares pursuant to section 102 of the Act.

[49] Sears Holdings issued a Notice of Variation and Change of Information dated April 7, 2006 extending the expiry date of its Offer to August 31, 2006. It described the terms, but not the parties with whom it had entered into the Support Agreements. It also indicated that a subsequent going

private transaction was expected to close in December 2006. The extension by Sears Holdings of its Offer from April 19, 2006 to August 31, 2006 would ensure that no more than 120 days would elapse between the expiry of the Offer and the SAT. This meant that it would avoid the need to obtain a new independent valuation and would also allow shares tendered under the insider bid to be counted when the required "majority of the minority" approval was sought in connection with the SAT.

[50] On April 10, 2006, Sears Canada issued two press releases concerning changes to the composition of its senior management team. In the first press release, Sears Canada announced that Brent Hollister, the President and CEO of Sears Canada would be stepping down effective May 9, 2006, would leave the company and would not stand for re-election to its board of directors. The second press release announced that Dene Rogers, a senior executive of Sears Holdings, had been appointed to the role of Acting President of Sears Canada, effectively replacing Mr. Hollister.

[51] On April 12, 2006, the independent directors of Sears Canada issued a Notice of Change of Directors' Circular relating to the revised Offer. This Notice of Change indicated that on April 11, 2006, Genuity had provided to members of the Special Committee a summary of its updated Valuation and Inadequacy Opinion together with a description of the due diligence it had undertaken in its preparation. The Notice included a copy of the updated Genuity Valuation which reaffirmed that the fair market value of Sears Canada shares as of April 11 was $19.00 to $22.25 and that Sears Holdings' revised Offer remained inadequate. The Notice also stated that the Special Committee had unanimously determined not to make a recommendation concerning the revised Offer. The Special Committee continued to have a number of reservations with respect to the revised Offer of Sears Holdings which were detailed in this Notice of Change.

[52] On April 14, Pershing, Hawkeye and Knott formed a group to oppose the efforts of Sears Holdings to take Sears Canada private. On April 17, 2006, they jointly announced that they had formed a group to "take all appropriate action to halt" the Sears Holdings bid. They also disclosed that they collectively owned 8,241,572, approximately 7.7 percent, of the then outstanding common shares of Sears Canada.

[53] On May 9, 2006, Sears Canada held its annual meeting at which a new board was elected comprised of four Sears Holdings employees, an employee of Sears Canada and three "independent" members nominated for election by Sears Holdings.

D. The Hearing

[54] The hearing on the merits to consider the two Applications commenced on July 4, 2006 and took place over three consecutive days. We heard evidence over the first two days of the hearing and closing submissions were made by the parties on the last day. In total, seven witnesses were called to testify. They were: William Ackman, the founder and principal of Pershing; William Anderson, the Chair of the Special Committee of Sears Canada; Richard Murawczyk, an investment analyst and member of Knott; Richard Rubin, a managing member of Hawkeye; William C. Crowley, the Executive Vice President, Chief Financial Officer and Administrative Officer of Sears Holdings; Kieran O'Donnell, an employee of BNS and a member of the Capital Markets Group of Scotia Capital; and Greg Rudka, an employee in the Investment Banking Group of Scotia Capital.

II. Summary of Allegations and Relief Sought by Sears Holdings

A. The Allegations

[55] The main allegations or submissions made by Sears Holdings against the Pershing Group are summarized as follows:

> (1) Pershing and its joint actors acquired beneficial ownership of common shares of Sears Canada during the Offer period and failed to comply with the early warning disclosure requirements under sections 101 and/or 102 of the Act;
>
> (2) Pershing issued a news release with respect to its acquisition of common shares of Sears Canada during the Offer period that failed to comply with the requirements of section 198 of the Regulations and contained material misrepresentations contrary to section 126.2 of the

Act;

(3) Pershing and its joint actors engaged in activities that resulted in an artificial price of Sears Canada shares contrary to section 126.1 of the Act; and

(4) Pershing and its joint actors engaged in abusive minority tactics contrary to the public interest.

B. Order Sought by Sears Holdings

[56] Sears Holdings seeks the following relief from the Commission:

(i) an order that Pershing and its joint actors be reprimanded;

(ii) an order requiring that Pershing and its joint actors comply with Part XX and the related regulations by selling into the market the common shares of Sears Canada each of them purchased during the period in which they were required to disclose their position as joint actors under Part XX but failed to do so;

(iii) an order requiring that Pershing and its joint actors be prohibited from acquiring any further common shares of Sears Canada;

(iv) or in the alternative, an order directing that the votes attached to any common shares of Sears Canada owned or controlled by Pershing and its joint actors be excluded in determining whether minority approval of any subsequent acquisition transaction in connection with the Offer has been obtained pursuant to Rule 61-501.

III. Sears Holdings – Allegations Against the Pershing Group

[57] Sears Holdings alleges that the Pershing Group has violated sections 101, 102, 126.1 and 126.2 of the Act and has engaged in abusive minority tactics contrary to the public interest. The particulars of their allegations are discussed below.

A. Did Pershing Violate the Early Warning Requirements of Sections 101 and 102 of the Act?

[58] On April 7, 2006, Pershing issued a press release (the "April 7 Press Release") disclosing that it owned 5,601,400 common shares of Sears Canada, representing approximately 5.2 percent of the outstanding common shares. This was Pershing's first public disclosure filing relating to its holdings in Sears Canada. In the same press release, Pershing also disclosed, for the first time, that Pershing was entitled to the economic benefit of an additional 6,900,000 common shares of Sears Canada as a result of certain cash-settled derivatives transactions it had entered into with SunTrust (the 2005 and 2006 Pershing Swaps).

[59] Between October 31 and December 8, 2005, Pershing sold its then entire position of 5.3 million Sears Canada Shares in connection with entering into the 2005 Pershing Swaps. Mr. Ackman testified at the hearing that these shares were sold in "market-on-close" transactions which were arranged by SunTrust with one or more ultimate counterparties including BNS (although at the time of the trades the identity of the counterparty was not known to Pershing).

[60] According to Mr. Ackman's Affidavit of June 14, 2006, the purpose of entering into the 2005 Pershing Swaps "was to minimize its exposure to Canadian withholding taxes by disposing of its Sears Canada shares prior to receiving the Sears Canada dividend while maintaining an economic interest in the performance of Sears Canada shares." Mr. Ackman further indicated that the 2005 Pershing Swaps were arranged in the fall of 2005 before Sears Holdings announced its intention to proceed with its Offer.

[61] On March 16, Pershing began again to purchase shares of Sears Canada in the open market and continued to do so up until April 6, 2006.

[62] On March 31, 2006, Pershing sold 1,600,000 shares of Sears Canada and entered into another equity swap transaction with SunTrust for an equivalent number of shares. This occurred prior to Sears Holdings' announcement that it had entered into the Vornado Agreement and the Support Agreements.

Evidence, Law and Analysis

[63] Sears Holdings alleges that the Pershing Group, due to their actions with each other and/or with third parties, violated sections 101 and 102 of the Act by failing to comply with the applicable early warning disclosure requirements.

[64] Subsection 101(1) of the Act requires an "offeror that acquires beneficial ownership of, or the power to exercise control or direction over … voting or equity securities of any class of a reporting issuer that, together with each offeror's securities of that class, would constitute 10 percent or more of the outstanding securities of that class" to issue and file forthwith a news release containing the prescribed information and, within two business days, to file a report. For purposes of section 101, an offeror is defined to include a person or company who acquires a security, whether or not by way of a take-over bid, issuer bid or offer to acquire.

[65] During the course of a formal take-over bid, the relevant reporting threshold pursuant to section 102 of the Act is reduced from 10 percent to 5 percent. The purpose of section 102 of the Act is to provide a signal to the marketplace that competing bidders may be interested in making a formal bid (or blocking a formal bid) and that others are purchasing the target issuer's shares [*Securities Law & Practice*, Thomson Canada Limited, 2006, at para. 20.15.1].

[66] The trading records over the relevant period of time showed that Hawkeye and Knott owned 1.4 percent and 1 percent, respectively, of the total outstanding shares of Sears Canada and therefore did not violate sections 101 or 102 of the Act in the absence of any finding that they were joint actors with Pershing.

[67] Similarly, the trading records indicate that at no point during the relevant time did Pershing own more than 10 percent of the outstanding Sears Canada shares. On its face, and subject to the discussion below, Pershing did not violate section 101 of the Act.

[68] Pershing's trading records show that between February 9, 2006 (the day the bid was made) and April 6, 2006 (the last day that Pershing acquired Sears Canada shares), Pershing crossed the five percent reporting threshold of section 102 of the Act on April 6, 2006 as a result of its purchase of 1,868,400 Sears Canada shares. The next business day, Pershing issued the previously discussed April 7 Press Release. Based on this evidence, Pershing did not violate section 102 of the Act.

[69] The analysis does not end there, however. In determining whether a party has acquired securities in excess of the 10 percent and 5 percent thresholds in sections 101 and 102 of the Act, respectively, one must aggregate the number of securities which a party beneficially owns or exercises control or direction over, with those which its "joint actors" beneficially own or exercise control or direction over. In other words, the relevant thresholds in sections 101 and 102 of the Act are aggregated for persons acting "jointly or in concert".

[70] Section 91 of the Act provides that it is a question of fact as to whether persons are "acting jointly or in concert". The purpose of section 91 of the Act is to ensure that all persons or companies who are effectively engaged in a common investment or purchase program, whether in support of, or in opposition to, a take-over bid, abide by the rules that govern securities transactions prior to, during and subsequent to the bid (*Report of the Committee to Review the Provisions of the Securities Act (Ontario) Relating to Take-Over Bids and Issuer Bids* (Toronto: Securities Commission, September 23, 1983)).

(i) Were Pershing and Vornado "Joint Actors"?

[71] Sears Holdings has asked us to determine, as a matter of fact, that Pershing was acting jointly and in concert with Vornado, at least up until the time that Vornado decided to enter into the Deposit

Agreement with Sears Holdings on April 1, 2006. If we were to reach that conclusion based on the evidence, they say Pershing would have contravened both sections 101 and 102 of the Act because Sears Canada shares acquired by Pershing from March 16 to March 31, 2006, when aggregated with the 7.5 million Sears Canada shares then held by Vornado, would have exceeded both the 10 and 5 percent thresholds set out in these sections.

[72] What did the evidence establish about the relationship between Pershing and Vornado? On or about February 15, 2005, Pershing entered into an arrangement with Vornado pursuant to which Pershing agreed to split with Vornado its purchases of Sears Canada shares. Between February and September, 2005, Pershing sold to Vornado approximately 7,400,000 Sears Canada shares pursuant to this arrangement.

[73] Mr. Ackman, during his cross-examination by counsel for Sears Holdings, indicated that this joint purchasing arrangement with Vornado was oral and was both entered into and terminated over the telephone. Mr. Ackman explained that, as both Vornado and Pershing wanted to buy Sears Canada shares over the relevant period, Vornado suggested that they split the stock purchases rather that "compete in the marketplace". Mr. Ackman testified that the arrangement was terminated at the end of September because Vornado "had no interest in buying additional shares".

[74] In support of its allegation of continuing "joint activity" between Pershing and Vornado, counsel for Sears Holdings drew to our attention a "finder's fee" of $2.5 million that Vornado indicated it would pay to Pershing towards the end of February, 2006. Mr. Ackman confirmed in his Reply Affidavit and in his testimony that in the fall of 2005, he had approached Mr. Roth, Chairman and CEO of Vornado, and requested that Vornado pay Pershing a finder's fee for bringing the Sears Canada investment opportunity to the attention of Vornado and that Mr. Roth had agreed to consider Pershing's request. When pressed as to the unexplained timing gap between the request and Vornado's decision to pay the fee Mr. Ackman testified that:

> "I think the reason why he had to determine – finalize the amount of the fee in February, is they were in the process of filing their 10-K with the SEC, and that they needed to accrue for what the amount of the fee was in preparation with that filing."

(Hearing Transcript dated July 4, 2006 at page 90)

[75] According to the evidence, on April 2, 2006, Mr. Roth of Vornado phoned Mr. Ackman at home to alert him to the fact that he had entered into the Deposit Agreement with Sears Holdings. This call came one day prior to Sears Holdings' public announcement relating to the Vornado Agreement. The evidence was that Mr. Ackman was surprised by this turn of events. There was no evidence advanced to suggest that Mr. Ackman knew of the Vornado Agreement or the negotiations that led up to it prior to this point in time.

[76] In this regard, Sears Holdings relied upon an e-mail that was sent from Mr. Ferguson of Pershing after Pershing learned of the Vornado Agreement, in which he stated: "I can't believe these guys tendered. Talk about getting sold out."

[77] Mr. Ackman explained this comment, however, in the course of his evidence as follows:

> "It was not a good day for minority shareholders of Sears Canada when Vornado announced the Deposit Agreement because it increased the probability that minority holders were going to get squeezed out at a below-market price, a price significantly below fair value.
>
> What made it particularly upsetting to us is that we brought this idea to Vornado to begin with. So here we give them this investment idea on which they made a hundred million dollars, and then they effectively cost us a lot of money by choosing to tender. And had we not even brought this idea to the attention of Vornado, we would have been much better off. And I think Mr. Ferguson is expressing that frustration."
>
> (Hearing Transcript dated July 4, 2006 at page 97)

[78] We accept Mr. Ackman's explanation for this e-mail and reject Sears Holdings' contention that it provides evidence of joint activity between Pershing and Vornado over the period of the Offer.

[79] Sears Holdings submits that a formal agreement between parties, while helpful in establishing joint actor status from an evidentiary point of view, is not a prerequisite (*Re 243978 Alberta Limited et al.* (1982), 4 O.S.C.B. 566C). We agree with this general proposition. However, in the absence of the proverbial "smoking gun", there must be evidence to support a finding that parties have acted jointly or in concert. Credible and plausible alternative explanations were provided by Pershing, as noted above, in reference to the evidence relied upon by Sears Holdings in support of its allegation. We therefore conclude that the evidence does not support Sears Canada's contention that Vornado and Pershing acted jointly or in concert for purposes of their obligations under sections 101 and 102 of the Act or in connection with the Offer more generally.

[80] We note, in obiter, that Sears Holdings' allegations were focused on Pershing having acted jointly or in concert with Vornado. The necessary corollary to such a finding (which we have rejected as noted above) would be that Vornado acted jointly or in concert with Pershing although no such allegation was made by Sears Holdings against Vornado. Sears Holdings' request that the Commission exclude the votes attached to shares of Sears Canada owned or controlled by "Pershing and its joint actors" for purposes of determining minority approval of the SAT may equally have applied to Vornado had we made a finding of joint actor status as we were urged to do so by Sears Holdings. In light of our determination on this issue, we need not address the consequential implications that a finding against Pershing might have had on Vornado.

(ii) Are Pershing, Hawkeye and Knott Joint Actors?

[81] The essence of Sears Holdings' allegation is that the principals behind the Pershing Group – Mr. Ackman of Pershing, Mr. Rubin of Hawkeye and Mr. Murawczyk of Knott – purchased shares during the Offer period as a result of an agreement, commitment or understanding with each other with respect to Sears Canada shares and in order to "thwart the Offer" and to prevent Sears Holdings from securing the "majority of the minority" approval required for the SAT to proceed.

[82] Their allegations in this regard involve Mr. Mayers of Desjardins Securities Inc. (Desjardins), a broker who had telephone conversations with the Pershing Group principals over the period of the

Offer. In the course of cross-examination, Mr. Ackman, Mr. Rubin and Mr. Murawczyk were asked to explain various conversations that each of them had had with Mr. Mayers in relation to the Offer. These conversations were contained in a transcript that had been prepared at the behest of Commission Staff based on tapes of telephone conversations previously provided to Commission Staff by Desjardins.

[83] Sears Holdings submitted that, in the event the Commission were to determine that the Pershing Group acted jointly and in concert prior to April 6, 2006 (the date of the last purchase of Sears Canada shares by one of the Pershing Group parties), this would support a finding of a breach of section 102 of the Act because, taken together, the Pershing Group holds more than 5 percent of the outstanding shares of Sears Canada.

[84] The evidence established that, on April 6, 2006, the Pershing Group met to discuss the Sears Canada situation. Messrs. Ackman and Rubin attended a meeting held on April 10, 2006, organized by Mr. Mayers. They apparently discussed Mr. Mayers' proposal that he be elected as an independent director of Sears Canada. We learned little about the outcome of this meeting.

[85] The evidence was that the Pershing Group determined on April 14 to form a group to oppose the Offer and Sears Holdings' efforts to take Sears Canada private. This was the subject of a press release issued on April 17 by the Group. It stated, in part, as follows:

> "… These shareholders believe that Sears Holdings is engaging in coercive tactics to force the minority shareholders of Sears Canada to enter into an undervalued and unsupported offer. As such, the group intends to take all appropriate legal action to halt the transaction so Sears Canada remains a public company, or, alternatively, to ensure that those shareholders who desire to sell their shares in Sears Canada are treated fairly."
>
> (Exhibit 63 to the Pershing Application Record)

[86] Despite lengthy cross-examinations of Mr. Ackman as well as Mr. Rubin and Mr. Murawczyk, the evidence does not support the allegation that the Pershing Group parties acted jointly or in concert prior to April 14 when they clearly joined forces and promptly announced their joint purpose in the April 17 Press Release referenced above.

[87] In support of their allegations, Sears Holdings relied upon the Desjardins transcript to show that Mr. Mayers and Mr. Ackman were attempting to make lists of shareholders that opposed the bid. However, counsel for Pershing, in his closing submission, argued that this activity was innocuous and reflected the same process that was going on in the Sears Holdings camp. Counsel for Pershing in referring to Mr. Ackman' testimony described the process as follows:

> "This is like an election. You keep a tally. You try and figure out who is going to do what. There is nothing wrong in that. It happens all the time. Who is a friend? Who is a foe?"
>
> (Hearing Transcript dated July 6, 2006 at page 127)

[88] For purposes of section 102 of the Act, subsection 89(1) of the Act provides that an "offeror's securities" includes securities "beneficially owned, or over which control or direction is exercised, on the date of an offer to acquire, by the offeror or any person acting jointly or in concert with the offeror."

[89] Although the Act does not define "control or direction" over securities, the Commission has held that in order to exercise control or direction over shares of a company not owned by the offeror, the offeror must have the ability to exercise the attributes of ownership – voting power and investment power, including the power to acquire or dispose of the shares (*Re Robinson* (1996), 19 O.S.C.B. 2643 at 2675).

[90] Based on the evidence and for the reasons set out above, we have concluded that Sears Holdings has failed to make out its claim that Pershing, Hawkeye and Knott were acting jointly or in concert prior to April 6, 2006, and we therefore do not find that they violated section 102 of the Act.

(iii) Did Pershing Use Swaps to Avoid Disclosure Obligations?

[91] In their written submissions, Sears Holdings alleged that "Pershing contravened sections 101 and 102 of the Act through its use of swap arrangements to dispose of beneficial ownership of its Sears Canada shares with the understanding that it would exercise a degree of direction or control over the shares that were the subject of the swaps."

[92] Sears Holdings also alleges that Pershing and its joint actors have engaged in abusive minority tactics by seeking to "park" 6.9 million common shares of Sears Canada that are the subject of total return swaps with SunTrust, with the understanding that: (a) the Pershing/SunTrust Swaps could be unwound and the 6.9 million shares returned to Pershing; and (b) in any SAT, the votes attached to the 6.9 million shares would be voted as directed by Pershing or not voted at all.

[93] Based on this understanding, Sears Holdings submits that Pershing secretly acquired shares of Sears Canada in the market during the Offer period, without disclosing to the public the fact that Pershing understood it had control or direction of the votes attached to these shares. Sears Holdings submits that Pershing understood that the 6.9 million shares that were the subject of the swaps would either be returned to Pershing or not voted, and therefore it had "parked" the 6.9 million shares by removing them from the pool of shares that would be voted in the minority approval of the SAT.

[94] Sears Holdings further alleges that Pershing used the swap transactions to avoid its reporting obligations under the Act. This "parking behaviour" on the part of Pershing, they say, raises serious public interest concerns, and even if no breach of the Act can be proven, constitutes abusive minority tactics that ought to engage the public interest jurisdiction of the Commission.

[95] Pershing sold 5.3 million Sears Canada shares in connection with entering into the Pershing 2005 Swaps. As discussed above, they did so for tax reasons relating to the extraordinary dividend that had been declared by Sears Canada as a result of the sale of its Credit Card business in the fall of 2005.

[96] On March 31, 2006, Pershing entered into a further swap transaction with SunTrust involving 1,600,000 Sears Canada shares.

[97] In their written submissions, Sears Holdings acknowledged that: "The effect of the swap arrangements between Pershing and SunTrust, all of which ended up being cash-settled swaps, was that Pershing would maintain an economic interest in the performance of … Sears Canada shares." (Sears Holdings Written Submissions at para. 115.)

[98] Mr. Ackman was forthright in giving his evidence with regard to the Pershing 2005 Swap Transactions. He confirmed that he liked Sears Canada as an investment and wanted to retain economic ownership. He wanted to participate in "the appreciation of the stock" despite the need to sell the actual shares to avoid an undesirable tax consequence at the time (Hearing Transcript dated July 4, 2006 at page 179).

[99] With respect to the reason for the Pershing 2006 Swap which, as Mr. Ackman put it had initially puzzled Commission Staff, he explained that he did not expect, based on what he knew about Mr. Lampert's approach to business transactions, that Mr. Lampert would raise his bid above $16.86. [Edward Lampert is the Chairman of Sears Holdings Corporation and the Chairman of ESL Investments]. Indeed, Sears Holdings had said as much publicly. The shares of Sears Canada had consistently traded above the Offer price and with the bid set to expire on March 31, Mr. Ackman believed the insider bid would fail and Sears Canada would remain a public company.

[100] Pershing therefore began to purchase shares of Sears Canada in the open market as of March 16. Mr. Ackman described himself as a long-term investor in Sears Canada who bought shares "before Mr. Lampert ever owned a single share." He testified that he believed in the long term prospects of the company.

[101] In reference to the Pershing 2006 Swap, Mr. Ackman's evidence was that he wanted to increase his exposure to the shares of Sears Canada while remaining below a public reporting position. When pressed to explain this by counsel for Sears Holdings, Mr. Ackman explained his motive as follows:

> "… I wanted to be able to maintain this economic ownership in Sears without raising – without Eddie Lampert knowing that I wanted to – that I was the guy who had been buying stock during his offer.
>
> And the reason why I didn't want to do that is it's like throwing, you know, salt into the eyes of the dragon. You know you don't go off and – it's an act of war, in a situation like this, for me to surface as a buyer of a stock in his deal."
>
> (Hearing Transcript dated July 4, 2006 at page 191)

[102] In other words Mr. Ackman did not want to antagonize Mr. Lampert, a significant participant in the U.S. capital markets, with whom he expected to have business dealings in the future.

[103] As it turns out, when Pershing sold its shares in 2005 in connection with the Pershing 2005 Swaps, BNS was a purchaser of the shares. Pershing did not know who had purchased the shares and BNS did not know who had sold them. It is self-evident that Pershing did not continue to exercise "control or direction" over the shares it sold which were bought by BNS.

[104] The Pershing 2006 Swap was a cash-settled transaction. Mr. Ackman's Affidavit states that Pershing did not maintain a legal or beneficial interest in, or the power to exercise control or direction over, any or the 1,600,000 Sears Canada shares related to the Pershing 2006 Swap.

[105] In their written submissions, Commission Staff maintain that, even if the 1,600,000 Sears Canada shares were under the control or direction of Pershing after March 31, the trading data provided by Pershing shows that it would not have affected the date by which Pershing crossed the 5 percent threshold contained in section 102 of the Act. There was no evidence adduced by Sears Holdings to support a finding that Pershing and its Swap counterparties had an understanding that the shares would be returned or otherwise made available to be voted so that Pershing could be said to exercise "control or direction" over the shares within the meaning of sections 101 and 102 of the Act notwithstanding that Pershing did not have legal ownership.

[106] Based on the evidence and the law, there is no basis to conclude that Pershing violated sections 101 and 102 of the Act through the use of the Pershing 2005 and 2006 Swaps.

[107] This still leaves the issue of whether their conduct in using the swaps to avoid disclosure obligations under the Act was "abusive of the capital markets" so as to engage the Commission's public interest jurisdiction.

[108] Counsel for Pershing relies upon the fact that swap arrangements are "perfectly normal economic transactions". In closing argument, he said:

> "They are entered into all of the time by many of the participants in this proceeding and there is nothing whatsoever untoward about entering into a swap transaction. It is a common practice. It is entirely consistent with the actions of a valued investor who believes strongly in the prospects of the company, but does not to want to own the shares."
>
> (Hearing Transcript dated July 6, 2006 at pages 122-123).

[109] Counsel for Pershing pointed out to us that Pershing's assessment of its reporting obligations in relation to the swaps was apparently shared by RBC. Evidently, between April 3 and 6, 2006, RBC, which owned 3.9 million Sears Canada shares at the time, purchased cash-settled swaps on 3.9 million shares for a total economic exposure of 7.8 million shares constituting approximately 7.2 percent of the outstanding Sears Canada shares. It made no public disclosure of these transactions.

[110] Based on the evidence we heard and in light of Mr. Ackman's explanation as to the reason he entered into the Pershing 2005 and 2006 Swaps, we have concluded that there is insufficient evidence to support a finding that Pershing's conduct in this regard was abusive of the capital markets so as to invoke our public interest jurisdiction under section 127 of the Act.

[111] This finding is based on the evidence and circumstances of this case. We wish to underscore that there might well be situations, in the context of a take-over bid, where the use of swaps to "park

securities" in a deliberate effort to avoid reporting obligations under the Act and for the purpose of affecting an outstanding offer could constitute abusive conduct sufficient to engage the Commission's public interest jurisdiction. This is not such a case.

B. Did Pershing's April 7 Press Release Violate Section 198 of the Regulation?

[112] On April 7, 2006, Pershing issued a Press Release announcing that it had acquired more than 5 percent of the shares of Sears Canada. The Press Release disclosed that Pershing held 5,601,400 Sears Canada shares and was entitled to the economic benefit of an additional 6,900,000 shares, for a total economic interest in Sears Canada equal to approximately 11.6 percent.

[113] Sears Holdings alleges that the Pershing Press Release failed to disclose either Pershing's purpose in acquiring Sears Canada shares during the Offer period or its intention to acquire further common shares of Sears Canada in violation of section 198(e) of the Regulation under the Act.

[114] Sears Holdings submits that the April 7 Press Release was silent on the purpose of Pershing in acquiring shares during the Offer period, stating only that:

> "Pershing Square and its affiliates intend to exercise all of their legal rights, including appraisal rights to ensure that their reasonable expectations are not frustrated and to ensure that they receive fair value for their investments in Sears Canada."
>
> (Sears Holdings Written Submissions at para. 149)

[115] It was obvious, they say, that this was not the only purpose Pershing had in acquiring shares during the Offer period. Rather, given that Pershing acquired shares after Sears Holdings announced that majority of the minority approval of the SAT was assured, Sears Holdings says that the true purpose was to maintain the price of Sears Canada shares above the Offer price. This true purpose was not disclosed, they say. Additionally, in failing to disclose that Pershing was acting jointly or in

concert with other shareholders including Knott and Hawkeye in order to thwart the Offer, Pershing's Press Release also violated section 126.2 of the Act.

[116] We note that, in addition to the paragraph in the Press Release which Sears Holdings pointed out to us in support of their allegation, reproduced above, the Press Release also says:

> "Pershing Square believes that the consideration offered by Sears Holdings Corporation … has been, and continues to be, wholly inadequate and intends that the Pershing Square funds will remain shareholders of Sears Canada rather than accept the current offer by Sears Holdings."
>
> (Exhibit 58 of the Pershing Group Application Record)

[117] It appears to us that this expression of dissatisfaction with the Offer combined with their stated intention to remain shareholders of Sears Canada is consistent with their actions in purchasing shares on April 6, 2006 and constitutes adequate disclosure for purposes of section 198 of the Regulation.

[118] Similarly, we reject any claim that the Press Release failed to disclose "any future intention to increase the beneficial ownership, control or direction" of Pershing over shares of Sears Canada. As Pershing's counsel put it:

> "…Pershing Square had no intention when its press release was issued on April 7, 2006 to acquire, and has not in fact acquired, any additional legal or beneficial ownership of, or control or direction over, Sears Canada shares…
>
> Holdings seeks to impute to Pershing Square an intention it did not have, and then to fault Pershing Square for failing to disclose this non-existent intention. For obvious reasons its contention is fallacious."
>
> (Pershing Group's Written Submissions at paras. 326 and 327)

[119] In conclusion, we find that Pershing's April 7 Press Release constituted adequate disclosure for purposes of section 198 of the Regulation and dismiss Sears Holdings' allegation in this regard.

C. Did Pershing Engage in a Course of Conduct that Violated Sections 126.1 and 126.2 of the Act?

[120] Sears Holdings alleges that Pershing and its joint actors engaged in a course of conduct that they knew, or ought reasonably to have known, would result in an artificial price for the Sears Canada shares contrary to section 126.1 of the Act by secretly acquiring shares during the Offer period and by orchestrating carefully "calculated and unattributed" press coverage for the purpose of maintaining the price of Sears Canada shares.

[121] It is submitted that Pershing was timing its purchases of Sears Canada to maintain its share price above the Offer price. Sears Holdings submits that this conduct violated section 126.1 of the Act because Pershing and its joint actors knew or reasonably ought to have known that it would result in an artificial price for the shares of Sears Canada.

[122] Two provisions in the Act address the issue of market manipulation. Section 126.1 of the Act provides that:

> 126.1 A person or company shall not, directly or indirectly, engage in or participate in any act, practice or course of conduct relating to securities or derivatives of securities that the person or company knows or reasonably ought to know,
>
> (a) results in or contributes to a misleading appearance of trading activity in, or on artificial price for, a security or derivative of a security; or
>
> (b) perpetrates a fraud on any person or company.

[123] Section 126.2 of the Act prohibits a person or company from making a statement that the person or company knows or reasonably ought to know is misleading or untrue in a material respect or omits to state a fact required to be stated in order to make a statement not misleading where the statement would reasonably by expected to have a significant effect on the market price of a security.

[124] The essence of Sears Holdings' allegation in this regard is that Pershing and its joint actors violated section 126.1 of the Act by deliberately timing their purchases of Sears Canada shares during the Offer period in order to artificially maintain the price of the shares above the Offer price.

[125] Sears Holdings contends that the timing of Pershing's purchases on March 16 (the day before the Offer was originally scheduled to expire) and on April 6 (the same day the Support Agreements were announced) supports the inference that these purchases were made by Pershing to maintain the price of Sears Canada shares.

[126] They maintain that this trading activity was coupled with a media campaign in which Pershing attempted with the assistance of Mr. Mayers of Desjardins, by means of incomplete and misleading disclosure to reporters, to create the impression that the SAT would not occur due to failure to win majority of minority approval, the Offer would fail and a higher Offer price would be forthcoming.

[127] What is an "artificial price" for a security? An artificial price for a security is one that differs from the price that would prevail had the market operated freely and fairly on the basis of true market supply and demand. Creating a misleading appearance of trading activity in a security distorts normal forces of supply and demand and such conduct is contrary to the public interest because it misleads other buyers and sellers (*Re Roche Securities Ltd*., [2004] A.S.C.D. No 400 (QL) at paras. 53-57; and *Re Podorieszach*, (2004) ABSECCOM REA #1459118v1).

[128] Securities regulators generally evaluate allegations of market manipulation by considering the nature of the trades and the circumstances surrounding their execution. Individual trades must not be reviewed in isolation. Similarly, the conduct of an alleged market manipulator must be

considered as a whole to determine whether he or she has attempted to sustain an artificial price by creating the appearance of public interest at a particular price level (*Re Cycomm International Inc.* (1994), 17 O.S.C.B. 21; *Re Fatir Hussain Siddiqi*, [2005] B.C.S.C.D. No 542 (QL) at paras. 114-118).

[129] Pershing's counsel submits, and Commission Staff agrees, that there was either no, or insufficient, evidence led to support a finding that Pershing breached either section 126.1 or section 126.2 of the Act.

[130] The Pershing Group's trades were executed through the facilities of the TSX at the prevailing market price. They were executed during the trading day, not timed to coincide with the close of the market.

[131] Sears Holdings asks us to conclude, based on the fact that Pershing's trades took place on March 16 and April 6, as noted above, that the purchases were made for the purpose of maintaining the price of Sears Canada shares.

[132] Intent to manipulate can be inferred from circumstantial evidence. However, where two alternative inferences are equally plausible, intent to manipulate will not generally be inferred (*Sebastian v. Golden Capital Securities Ltd.*, [2006] B.C.J. No. 506 (Sup. Ct.) (QL) at para. 34).

[133] The conduct of Pershing and the Pershing Group when viewed as a whole, and in light of the surrounding circumstances, is consistent with their stated view that Sears Canada shares were undervalued, that the bid price was inadequate and that they would oppose the Offer.

[134] Pershing's counsel submits that, from the time that Sears Holdings first announced its Offer, Sears Canada shares have consistently traded at a premium to Sears Holdings' Offer price. He submits that, during this period of time, there were 120 trading days and the Pershing Group only executed trades in shares of Sears Canada on fewer than 10 percent of those days. These facts suggest that other shareholders of Sears Canada, besides the Pershing Group, must also have believed the bid price to be inadequate given that they were executing trades in the market at a premium to it.

[135] Based upon the evidence and for the reasons discussed above, we dismiss Sears Holdings' allegations that Pershing and its joint actors breached sections 126.1 and 126.2 of the Act through their trading activity.

[136] In conclusion, and for the reasons set out above, all of the allegations made by Sears Holdings against the Pershing Group are dismissed.

IV. Summary of Allegations and Relief Sought by the Pershing Group

A. The Allegations

[137] The Pershing Group states that its Application concerns the "important issue of whether the minority shareholders of a public company in Ontario are entitled to be treated equally and fairly when a bid is made by the majority shareholder of that company for their shares". The Application allegedly concerns unprecedented conduct by Sears Holdings that calls into question the "fairness, efficiency and integrity of the capital markets".

[138] The allegations in the Application filed on behalf of the Pershing Group in relation to Sears Holdings and its insider bid are summarized as follows:

(1) Sears Holdings violated subsection 97(2) of the Act by entering into the Support Agreements with BNS, Scotia Capital and RBC and the Deposit Agreement with Vornado;

(2) Sears Holdings violated subsection 94(2) of the Act by entering into the Support Agreements with BNS, Scotia Capital and RBC;

(3) Sears Canada shares held by BNS, Scotia Capital and RBC should be excluded for the purposes of minority approval of the second step going private transaction pursuant to subsection 8.1(2) of Rule 61-501;

(4) Sears Canada shares owned by Sears Holdings that were deposited by Vornado to the insider bid of Sears Holdings pursuant to the Vornado Agreement should be excluded for the purposes of minority approval of the second step going private transaction pursuant to subsection 8.2(b) of Rule 61-501;

(5) Sears Canada shares now owned by Sears Holdings that were deposited to the Offer of Sears Holdings should be excluded for the purposes of minority approval of the second step going private transaction given the failure of Sears Holdings to comply with paragraph 8.2(f) of Rule 61-501 and/or shareholders were coerced by Sears Holdings to tender;

(6) The Circular of Sears Holdings contained a misrepresentation arising from the failure to disclose the substantial shareholdings of Scotia Capital and BNS and the Circular as amended and varied on April 4, 2006 contained misrepresentations or material omissions arising from the failure of Sears Holdings to disclose the Support Agreements with BNS and Scotia Capital and the related Escrow Agreements;

(7) further or in the alternative, the Commission should exercise its public interest jurisdiction pursuant to section 127 of the Act to cease trade or prohibit the insider bid of Sears Holdings and its proposed second step going private transaction on the grounds that the conduct of Sears Holdings has been coercive and abusive of shareholders generally, including the minority shareholders of Sears Canada, jeopardizes the fairness and efficiency of the capital markets and confidence in those markets, and that such an order is necessary to protect investors in Sears Canada from the unfair and improper conduct and practices of Sears Holdings.

B. Order Sought by the Pershing Group

[139] In its Application, the Pershing Group originally sought various orders under subsections 104(1) and 127(1) of the Act as follows:

(a) pursuant to clause 104(1)(c) of the Act directing that Sears Holdings comply with the regulations related to Part XX of the Act (specifically, Rule 61-501) as follows:

(i) comply with section 8.1 of Rule 61-501 and exclude from the calculation of the majority of the minority on any second step going private transaction the shares of Sears Canada held by its joint actors, including BNS and Scotia Capital;

(ii) comply with section 8.2 of Rule 61-501 and exclude from the calculation of the majority of the minority on any second step going private transaction the shares of Sears Canada acquired by Sears Holdings from Vornado pursuant to the Vornado Agreement;

(iii) comply with section 8.2 of Rule 61-501 and exclude from the calculation of the majority of the minority on any second step going private transaction the shares of Sears Canada acquired by Sears Holdings pursuant to its take-over bid for Sears Canada from the date that is five business days after Sears Holdings has complied with the order requested in paragraph (c) below;

(b) pursuant to subsection 104(1)(b) of the Act requiring that Sears Holdings amend the terms of its Offer for the shares of Sears Canada to irrevocably exclude from the calculation of the majority of the minority on any second step going private transaction the shares of Sears Canada held by BNS, Scotia Capital and RBC;

(c) pursuant to subsection 104(1)(c) of the Act directing Sears Holdings to remedy its non-compliance with subsections 94(2) and 97(2) of the Act;

(d) pursuant to clauses 104(1)(b) and (c) of the Act requiring that Sears Holdings amend its Take-Over Bid Circular to:

(i) disclose that Sears Holdings will exclude from the calculation of the majority of the minority on any second step going private transaction the shares of Sears Canada that it is prohibited from including in such calculation as provided in paragraphs (a) and (b) above;

(ii) disclose the existence and terms of the Release granted to Vornado pursuant to the Vornado Agreement and to grant an identical Release to all other shareholders of Sears Canada whose shares are acquired under the take-over bid or in any second step going private transaction;

(iii) disclose the identities and interests of the parties to the Support Agreements, describe the collateral benefits received by them including the tax benefits to them and the liquidity covenant and disclose the banking relationship and any other material relationships between Sears Holdings, Sears Canada and the parties to the Support Agreements;

(iv) provide an opportunity of at least ten business days from the date of mailing of the amended Take-Over Bid Circular for all shareholders who tendered to withdraw their Sears Canada shares from the Offer notwithstanding that such shares may have been taken up and paid for; and

(v) correct all other misrepresentations and omissions in the Take-Over Bid Circular and all amendments and variations made thereto;

(e) pursuant to subsection 127(1) of the Act reprimanding Sears Holdings for violating subsections 94(2) and 97(2) of the Act and for disseminating a Take-Over Bid Circular or amendments and variations made thereto containing misrepresentations and omissions;

(f) pursuant to subsection 127(1) of the Act cease trading Sears Holdings' take-over bid for Sears Canada until the foregoing orders are complied with;

(g) in the alternative, an order pursuant to subsection 127(1) of the Act cease trading Sears Holdings' take-over bid for Sears Canada; and

(h) such other orders as counsel may request and the Commission considers appropriate.

[140] At the conclusion of the hearing, the Pershing Group submitted a draft Order outlining the revised nature of the specific relief they were seeking against Sears Holdings. It reads as follows:

"IT IS ORDERED pursuant to subsections 104(1) and 127(1) of the *Securities Act* (the "Act") that:

1. Sears Holdings Corporation and SHLD Acquisition Corp. ("Sears Holdings") have not complied with and are not complying with Part XX of the *Securities Act (Ontario)* and the regulations relating to such Part (collectively, "Ontario Securities Law") in respect of the bid (the "Offer") for shares of Sears Canada Inc. ("Sears Canada").

2. Sears Holdings is directed to comply with Ontario Securities Law in respect of the Offer and all other offers made or to be made for shares of Sears Canada.

3. The directors and senior officers of Sears Holdings Corporation and SHLD Acquisition Corp. are directed to cause their respective corporations to comply with, and to cease to contravene, Ontario Securities Law.

4. The Offer and any other offer made or to be made for shares of Sears Canada by Sears Holdings or any affiliate thereof is cease traded until:

(a) the support agreements entered into by Scotia Capital Inc. (Scotia Capital), Bank of Nova Scotia ("BNS") and Royal Bank of Canada ("RBC") in respect of the Offer are terminated; and

(b) the take over bid circular in respect of the Offer is amended to disclose that Sears Holdings will exclude from the calculation of the majority of the minority on any second step going private transaction the shares of Sears Canada held by or acquired from Scotia Capital, BNS and RBC and the shares of Sears Canada acquired by Holdings from Vornado pursuant to the Vornado Deposit Agreement."

[141] The Pershing Group also requests that the Sears Holdings Application be dismissed in its entirety.

V. The Pershing Group – Allegations Against Sears Holdings

A. Are BNS and Scotia Capital "Joint Actors" with Sears Holdings?

[142] For this part of the Reasons, it is important to understand who the various parties are, and, in the case of BNS and Scotia Capital, what the various business units are, and what retainers and involvement they had in relation to Sears Canada, Sears Holdings and the Sears Holdings Offer. Briefly, the structure of the entities and business units within BNS and Scotia Capital is as follows. Scotia Capital is a wholly-owned subsidiary of BNS. Scotia Capital is organized into two groups- Global Capital Markets and Global Corporate & Investment Banking. The Capital Markets Group (Scotia CMG) is a business sub-unit of Scotia Capital's Global Capital Markets with business lines serving both BNS and Scotia Capital. Scotia CMG's business activities include equity and credit derivatives, foreign exchange, interest rate hedging, debt capital markets and securitization. The Institutional Equity Group (Scotia IEG) is another sub-unit of Scotia Capital's Global Capital Markets. Scotia IEG's business activities include proprietary trading and the purchase of securities for risk arbitrage purposes. The Investment Banking Group and the Mergers and Acquisitions Group are sub-units of Scotia Capital's Global Corporate & Investment Banking. The manner in which BNS and Scotia Capital are organized and the way in which they are structured and operated

in order to clearly separate the relevant business units of BNS and Scotia Capital is not, we understand, atypical for integrated Canadian financial institutions.

[143] In November, 2005, Sears Canada engaged Scotia Capital to arrange a $500 million credit facility (the lending relationship). Scotia Capital had a banking relationship with Sears Holdings and was the lead banker on the financing for Sears Canada.

[144] On January 6, 2006, Sears Holdings engaged Scotia Capital to advise it with respect to the Offer and this retainer was put in writing on January 10, 2006, with effect as of January 6, 2006 (the "Engagement Letter"). Professionals from both Scotia Capital's Investment Banking and Mergers and Acquisitions Groups were assigned to the engagement team. For simplicity, the party engaged by Sears Holdings is referred to as Scotia M & A. Under the terms of the Engagement Letter, Scotia M & A was entitled to a work fee of $50,000.00 per month and a success fee of $400,000.00 if the Offer was successful at or below a share price of $16.86 (which did not happen and therefore Scotia M & A was not entitled to the success fee under the terms of its engagement). If the share price was increased above $16.86, the payment of a success fee was within the sole discretion of Sears Holdings and if Sears Holdings did not acquire a majority of the minority of the shares in Sears Canada, no success fee would be payable. No success fee was paid to Scotia M & A, a fact that Sears Holdings publicly announced and confirmed in evidence before us. According to the submissions of counsel for BNS and Scotia Capital, Scotia M & A is not entitled to and will not receive any other compensation beyond the monthly work fee described above.

[145] On February 8, 2006, Scotia M & A entered into a dealer-manager agreement with Sears Holdings (the Dealer-Manager Agreement). Scotia M & A is not entitled to any additional fees from Sears Holdings as a consequence of agreeing to act as dealer-manager. The Dealer-Manager Agreement provides for a solicitation fee of $.10 per share payable in respect of shares validly tendered to the Offer and not withdrawn. The Agreement provides for a maximum fee payable for each deposit. This solicitation fee is payable only to the individual broker within Scotia Capital's brokerage arm and other individual brokers within the brokerage firms that form part of the Canadian Solicitor Dealer Group in connection with the Offer. No solicitation fees are payable for shares tendered by Natcan or Vornado or for shares not tendered to the Offer but voted in favour of

any SAT that may be undertaken, including the shares of Sears Canada held by Scotia Capital, BNS and RBC.

[146] Against this background, the Pershing Group alleges that Scotia Capital and BNS are "joint actors" with Sears Holdings. They seek this determination in order that the votes attached to the Sears Canada shares held by Scotia Capital and BNS should be excluded from the minority in determining whether the SAT obtains "majority of the minority" approval. The Pershing Group submits that the public interest requires that parties which are as "linked" to the bidder as are Scotia Capital and BNS through the various Support Agreements, the financial advisor and dealer-manager engagements and lending relationships, ought not to be permitted to determine the outcome of a vote that is required to be determined by the true minority shareholders of the target.

Evidence, Law and Analysis

[147] The legal backdrop to consideration of this issue is fairly straightforward. The SAT is a business combination for Sears Canada under Rule 61-501 because it is the transaction by which Sears Holdings intends to acquire any Sears Canada shares that are not tendered to its Offer. In order for the SAT to be carried out, it must be approved by the minority shareholders. For purposes of Rule 61-501, the minority shareholders exclude any joint actors of Holdings.

[148] For purposes of Rule 61-501, the term "joint actors" is generally defined to mean persons or companies "acting jointly or in concert" with the offeror as defined in section 91 of the Act. Section 91 provides that it is a question of fact as to whether a person or company is acting "jointly or in concert" with an offeror.

[149] The policy underpinning of the joint actor concept is to ensure that all persons or companies who are effectively engaged in a common investment or purchase program, whether in support of or in opposition to a take-over bid, are required to abide by the requirements of Ontario securities law that govern securities transactions prior to, during and subsequent to the bid (Practitioners Report, at page 10, in *Securities Law and Practice*, 3rd edition, Borden Ladner Gervais LLP, Part 20, Take-Over Bids and Issuers Bids (Toronto: Carswell, 2002)).

[150] Subsection 91(2) of the Act provides that a registered dealer acting solely in an agency capacity for an offeror in connection with a take-over bid and that does not execute principal transactions for its own account in the class of securities subject to the offer to acquire or does not perform services beyond a customary dealer's functions will not be presumed, solely by reason of such an agency relationship, to be acting jointly or in concert. Subsection 8.1(2) of Rule 61-501 provides similarly.

[151] The Pershing Group submits that there are essentially four key elements of the relationship between Scotia Capital, BNS and Sears Holdings that points to a finding that they were all acting jointly or in concert with regard to the Offer and the SAT:

(a) Scotia Capital and BNS attach critical importance to their business relationship with Sears Holdings;

(b) The Offer and SAT, as revised, provide significant tax benefits to Scotia Capital and BNS;

(c) BNS has virtually no economic interest in the Sears Canada shares given the swap transactions it had entered into with SunTrust; and

(d) Scotia Capital's prospect of earning a success fee on the transaction.

[152] Scotia Capital and BNS submit that Scotia CMG, the sub-unit that acquired Sears Canada shares on behalf of BNS, and Scotia IEG, which acquired Sears Canada shares for risk arbitrage purposes, are effectively "walled off" from each other and from Scotia M & A, the group that provided financial advisory services to Sears Holdings. They submit that policies and procedures are in place relating to the handling of confidential and non-public information and that no evidence was adduced that these policies and procedures were not followed by Scotia M & A in relation to the Offer or that confidential, non-public information flowed from Scotia M & A to either Scotia CMG or Scotia IEG. Commission Staff emphasized that the creation of firewalls between and within the Canadian banks and their investment banking subsidiaries is a well-established and recognized practice.

[153] The Pershing Group submits that the existence of firewalls between BNS and Scotia Capital and the absence of the exchange of confidential information between them is not germane to the question of fact that must be determined in this case: Did BNS and Scotia Capital act jointly and in concert with Sears Holdings in planning, promoting and structuring the Offer to ensure its success beyond the customary role of a financial advisor? In addressing this question in the context of Part XX of the Act, the Commission and the courts have focused on whether there has been an agreement, commitment or understanding by two or more parties with respect to a common acquisition or investment program or the exercise of voting rights (*Re 243978 Alberta Limited et al* (1982), 4 O.S.C.B. 566C at 568C and 573C).

[154] Scotia Capital and BNS also deny that Scotia M & A, on the one hand, and Scotia CMG and Scotia IEG, on the other hand, had any actual commonality of interest in the outcome of the Offer. They submit that Scotia M & A was motivated solely, as a soliciting dealer for Sears Holdings, to identify shareholders and put them in contact with Sears Holdings so they could potentially negotiate their own terms for participation in the Offer. Scotia CMG and Scotia IEG, on the other hand, were motivated to maximize returns on their investments in Sears Canada shares in the most tax effective manner possible. This is, of course, a factual determination driven by the evidence we heard as discussed below.

[155] The Pershing Group concedes in their Application that, if Scotia Capital provided only customary advisory and administrative functions to Sears Holdings, it would not be presumed to be acting jointly or in concert with Sears Holdings. We are unable to conclude, based on the evidence, that Scotia Capital's role extended beyond the provision of customary advisory and administrative support to Sears Holdings. In particular, we note that neither Scotia Capital nor BNS acquired any shares of Sears Canada for their own account after Scotia Capital was engaged by Sears Holdings. We accept that it is a customary soliciting dealer function to identify the owners of shares of an offeree issuer and to ascertain their willingness to tender to the bid – which is what Scotia Capital did in this case.

[156] In the course of the hearing we heard testimony from Mr. Greg Rudka, a member of Scotia Capital's Investment Banking Group and the senior person on the Scotia M & A engagement team responsible for advising Sears Holdings in relation to their bid. In addition, we heard testimony from Mr. Kieran O'Donnell, an employee of BNS and a member of Scotia CMG. Mr. O'Donnell, whose evidence we found to be very cogent, straightforward and credible, swore in his Affidavit and emphasized in his viva voce evidence, that BNS and Scotia Capital, the two entities that signed the Support Agreements with Sears Holdings, did not, at any time, "work together" with the Scotia M & A team "to deliver the votes necessary to ensure the success of the Expropriation transaction" as alleged by Mr. Ackman in his Affidavit. This was borne out by the e-mail and other documentary evidence filed with us that showed that Scotia M & A did not take part in the negotiations and the decisions by BNS and Scotia Capital to enter into the Support Agreements. In fact, Scotia M & A was careful to insist that those negotiations take place directly between BNS and Scotia Capital and Sears Holdings and their respective counsel.

[157] In a particularly telling exchange of e-mails we reviewed, at one point Mr. Crowley, the Executive Vice President and CFO of Sears Holdings, and the principal in charge of overseeing the Sears Holdings Offer, became quite frustrated with the length of time it was taking to negotiate the Support Agreements with the Banks. He expressed this sense of frustration to Mr. Rudka and others within the Scotia M & A team and suggested that he wished to speak with the CEOs of both BNS and RBC to better understand the delays and the process timeline. As Sears Holdings' frustration level as a result of the delays grew, Mr. Rudka and his colleagues attempted to convey the gravity of the situation to Mr. O'Donnell and others who were working on the Support Agreements on the other side of the wall. Mr. O'Donnell responded that more time was required and was, it would appear, somewhat impervious to the pressure attempted to be applied by Scotia M & A and Sears Holdings. In short, BNS, Scotia CMG and Scotia IEG were motivated to take the necessary time in their negotiations to maximize returns on their investments in Sears Canada shares in the most tax-effective manner possible in their own, and in their shareholders' best interests. Their interest in this regard was independent of Sears Holdings' interest in successfully completing the bid and does not support a finding that they shared a commonality of interest with Sears Holdings in this regard.

[158] The Pershing Group also points to an unusual degree of collaboration and co-operation between BNS and RBC in the course of negotiating the Support Agreements with Sears Holdings, including an offer to share tax opinions with RBC. While this did, indeed, appear to be the case, it does not logically lead to a finding that they did so in an effort to assist Sears Holding in planning, promoting and structuring their Offer. Rather, it is consistent with the motivation of BNS and Scotia Capital to ensure that they were in the strongest position to negotiate Support Agreements which reflected terms which advanced their own best interests.

[159] In response to the Pershing Group's allegation that BNS has virtually no economic interest in the shares of Sears Canada, Mr. O'Donnell responded in his Affidavit that both BNS and Scotia Capital have a meaningful interest in the Sears Canada shares that they own. The Sears Canada shares purchased by Scotia Capital represent proprietary trading positions with full exposure to the value of Sears Canada shares. While BNS purchased its Sears Canada shares to reduce its exposure under its SunTrust swap agreements, it has exposure to the price of the shares as its after-tax return increases with an increased SAT share price and, accordingly, BNS has some economic interest in the shares.

[160] In the absence of cogent evidence that a party to a transaction intervened or attempted to manipulate the outcome of a bid or similar transaction, we are of the view that it would be a dangerous path for us to follow to exclude shares from voting or tendering into a transaction on the basis that the holder lacks a sufficient economic interest in the securities that are the subject of the transaction. Such an inquiry is highly subjective, fraught with factual uncertainty and ought not to be a determining factor in a contested take-over bid context. If this matter warrants study, it should be undertaken in a broader policy context. In this regard, it is also noteworthy that the traditional focus of our conflict of interest related rules as they apply to mergers and acquisitions is on those conflicts which give rise to a bidder's active intervention or the existence of collateral benefits that could distort the incentives for security holders (the latter issue is, of course, the subject of a distinct allegation of the Pershing Group and is dealt with as a distinct matter).

[161] While we accept that both Scotia Capital and BNS may well attach critical importance to their business relationship with Sears Holdings, as the Pershing Group claims, we cannot logically

proceed from that premise, accepting it to be true, to a finding that they acted jointly or in concert with Sears Holdings. As regards Scotia Capital's prospect of earning a success fee, the evidence was clear that there is no such prospect. Moreover, the prospect of a success fee was never assured from the outset of what were, evidently, difficult negotiations with Sears Holdings over fees in relation to Scotia Capital's engagement as financial advisor in connection with the Offer.

[162] The fact that Scotia Capital and BNS agreed, under the Support Agreements, to vote their shares in favour of the SAT does not establish that they were joint actors with Sears Holdings. If this were so, RBC would also be a joint actor with Sears Holdings on this basis, an allegation that was not made by the Pershing Group.

[163] The law, as described above, makes it clear that the provision by a dealer of financial advice in respect of an offer is not, on its own, sufficient to lead to the presumption of joint actor status. This safe harbor may not apply, however, where the dealer's activities include playing an integral role in presenting proposals to management and actively promoting the success of an offer, where such activities exceed what is customary for a dealer (*Re Seel Mortgage Investment Corporation and Dominion Trustco Capital Inc.* (1992), 15 O.S.C.B. 4287). The facts in *Seel* are distinguishable from this case.

[164] This leads us to the final assertion of the Pershing Group that the public interest compels a finding that Scotia Capital and BNS are joint actors with Sears Holdings. They say that public appearance and the perception of the investing public as a result of Sears Holdings, Scotia Capital and BNS engaging in transactions "perceived to be delivering collateral benefits" warrants Commission intervention. The allegations relating to collateral benefits and consideration of the appropriate consequences that ought to flow from any findings in this regard based on the Commission's public interest jurisdiction are dealt with in these Reasons as a separate matter.

[165] The evidence established that:

- BNS and Scotia Capital, through Scotia CMG and Scotia IEG respectively, purchased their shares in Sears Canada for their own accounts between August 31, 2005 and December 16, 2005

and neither conducted further trading in Sears Canada shares for their own accounts after December 16, 2005;

- Sears Holdings retained Scotia M & A on January 6, 2006 to provide financial advisory services in relation to its anticipated bid for Sears Canada and retained Scotia M & A to be dealer-manager for the Offer on February 8, 2006;

- As a result of information containment processes and internal controls, Scotia M & A was not aware that BNS or Scotia Capital owned Sears Canada shares prior to the solicitation process at the end of February 2006;

- Similarly, no one at Scotia CMG or Scotia IEG were aware that Sears Holdings was negotiating with or had retained, Scotia M & A until after the retainer was finalized;

- Scotia M & A took no part in the negotiations and decisions by BNS and Scotia Capital to enter into the Support Agreements; rather, these decisions appeared to be made independently of Scotia M & A and for business and commercial purposes unrelated to the Scotia M & A assignment;

[166] In conclusion, it does not appear, based upon the application of the law to the facts and the evidence before us, that Scotia Capital and BNS were "joint actors" of Sears Holdings in relation to their Offer and the SAT.

B. Were the Support Agreements Entered into in Contravention of Subsection 94(2) of the Act?

Law and Analysis

[167] The Pershing Group alleges that, by entering into the Support Agreements, Sears Holdings has contravened subsection 94(2) of the Act because it has entered into an agreement to acquire shares of Sears Canada other than pursuant to the Offer. Subsection 94(2) reads as follows:

> 94(2) An offeror shall not offer to acquire or make, or enter into, any agreement, commitment or understanding to acquire beneficial ownership of any securities of the class that are subject to a take-over bid otherwise than pursuant to the bid on and from the day of the announcement of the offeror's intention to make the bid until its expiry.

[168] Subsection 94(2) of the Act has very limited exceptions, including subsection 185(1) of the Regulations which were not argued to be applicable in this case.

[169] The policy purpose served by subsection 94(2) of the Act is to ensure that an offeror is not able to avoid or circumvent the equal treatment and other protections afforded target company shareholders under Ontario securities law by entering into a private agreement to acquire shares outside the bid, during the currency of the bid (*Report of the Committee to Review the Provisions of the Securities Act (Ontario) Relating to Take Over Bids and Issuer Bids*, cited above, at page 20).

[170] Sears Holdings says in response that the Support Agreements do not constitute agreements to acquire beneficial ownership of shares within the meaning of subsection 94(2) of the Act. Rather, they commit BNS, Scotia Capital and RBC to vote their shares in favour of the SAT. They argue that, if the Pershing Group's interpretation of the provision were to be accepted, then every instance in which an offeror announces its intention to carry out a SAT following completion of a bid (which the offeror would be legally obliged to disclose provided they have such an intention) would violate subsection 94(2) because it would constitute an "offer to acquire" or a "commitment to acquire" securities other than pursuant to the bid.

[171] The Pershing Group contends, however, that the Support Agreements in this case are properly viewed as private agreements to acquire shares entered into outside of, but during the course of, the bid. They say that this is so because the effect of entering into them was to guarantee satisfaction of

the Minority Approval requirement which, in turn, guaranteed the acquisition of the Sears Canada shares to be voted by BNS, Scotia Capital and RBC in favour of the SAT pursuant to the terms of the Support Agreements. Once the Support Agreement with RBC was signed, Sears Holdings had contractual commitments to support the SAT such that, in their words, "success of our Offer was assured." Accordingly, Pershing submits, "there could be no clearer understanding that Holdings would acquire Sears Canada shares held by BNS, Scotia Capital and RBC in the second step going private transaction and outside of the Offer."

[172] Commission Staff took the position, consistent with that of Sears Holdings, that the Support Agreements are not agreements to purchase Sears Canada shares outside of the Offer within the meaning of subsection 94(2) of the Act. However, they point out that it is unusual for a bidder to enter into a support agreement with a target shareholder during the course of a bid that provides for the target shareholder to vote their shares in favour of a SAT rather then tender into the bid. In this case, it is clear from the evidence that BNS, Scotia Capital and RBC were not prepared to tender to the bid as it was not in their economic best interests to do so. Mr. Kieran O'Donnell of BNS, in his Affidavit, clearly states that "the essence of the Support Agreements was that BNS and Scotia Capital would agree to hold on to their shares and vote them in favour of a form of second step going private transaction." (Affidavit of Kieran O'Donnell sworn June 22, 2006, Record of The Bank of Nova Scotia and Scotia Capital Inc., Volume 2, Tab 2, at para. 27).

[173] Commission Staff nonetheless submit that we might consider the unusual nature and effect of these Support Agreements in assessing, under our public interest jurisdiction, whether Sears Holdings' conduct in relation to the bid was "abusive" overall as alleged by the Pershing Group.

[174] We acknowledge that, on their face, the Support Agreements do not "technically" appear to offend subsection 94(2) of the Act because they are not, in form, agreements to purchase or acquire shares, but rather, agreements to vote shares in favour of the SAT. However, as Commission Staff concede, the nature of these Support Agreements is unusual. By the time the Support Agreements were released from escrow, approval of the SAT was effectively assured as explained above. The true substance and intended effect of the Support Agreements was that BNS, Scotia Capital and RBC would vote their Sears Canada shares in favour of the SAT and Sears Holdings would acquire their

shares pursuant to the SAT in December 2006. If one looks through the form of these agreements to their true substance and intended effect, the complaint that they contravene subsection 94(2) of the Act has merit.

[175] However, this allegation is not central to our Decision or Reasons and we have therefore determined that it is unnecessary to make a conclusive finding on this issue.

C. Did Sears Holdings Comply with its Disclosure Obligations?

[176] The Pershing Group has made a number of allegations that Sears Holdings failed to comply with its disclosure obligations in connection with its Offer. In particular, they allege that Sears Holdings' disclosure was deficient with regard to the following matters:

(a) Scotia Capital had been retained as Sears Holdings' financial advisor;

(b) Scotia Capital/BNS held shares of Sears Canada as principal;

(c) the Vornado Agreement included a Release in favour of Vornado in respect of any claims arising out of Vornado's purchases and sales of Sears Canada shares;

(d) the Support Agreements with Scotia Capital and BNS had been signed on March 28, 2006 and were being held in escrow pursuant to Escrow Agreements that had also been signed by them and Sears Holdings;

(e) Scotia Captial, BNS and RBC were the parties to the Support Agreements together with the specific terms of the Support Agreements;

(f) the lock-up agreement with Natcan contained a price-protection provision (although this was ultimately disclosed in the Sears Holdings' Circular it was not disclosed in the press release

which announced the Offer and simultaneously announced the Natcan Deposit Agreement); and

(g) the tax consequences of the Offer and the SAT were not properly and fully described in the Circular in that it did not expressly address the "stop-loss" and other income tax aspects of the deal that would have been of relevance to other Canadian corporations besides BNS, Scotia Capital and RBC.

[177] The essence of the Pershing Group's complaint as regards the standard of disclosure to which Sears Holdings adhered to in its press releases, Circular and Notice of Variation and Change in Information which described its revised Offer, is that, on the whole, it was inadequate and either not provided on a timely basis or not provided at all. The Pershing Group alleges that Sears Holdings failed to disclose, or failed to disclose on a timely basis, facts and information that they were obliged to disclose and that minority shareholders would consider to be material in the circumstances. As such, they say, remedial action is warranted.

[178] Sears Holdings says that the Pershing Group's allegations are without merit and proceed from the faulty premise that because something was not disclosed, the non-disclosure must be improper. They argue that, to warrant Commission intervention, non-disclosure must be coupled with an obligation to disclose. Below we review the disclosure complaints in more detail against the backdrop of what is required.

Arguments, Law and Analysis

[179] Under the Act, subsection 98(1) requires delivery of a take-over bid circular by the offeror. In the event of a change in the information contained in the bid circular that would reasonably be expected to affect the decision of security holders of the offeree issuer, the offeror is required under

subsection 98(2) to issue and deliver a Notice of Change in Information. The information required to be disclosed in these documents is prescribed by Form 32.

[180] Sears Holdings disclosed in its Circular that it had retained Scotia Capital as dealer-manager of the soliciting dealer group. It did not disclose, and maintains that it had no obligation to disclose, that Scotia Capital had also been retained to act as Sears Holdings financial advisor. However, it did in fact disclose in its February 9 press release which announced the mailing of the Offer that Scotia Capital had been retained as its financial advisor.

[181] Sears Holdings submits that it had no obligation to issue a Notice of Change of Information disclosing that Scotia Capital and BNS were shareholders of Sears Canada after it first became aware of this information.

[182] Sears Holdings also maintains that they had no obligation to disclose the fact that the Vornado Agreement included the litigation Release in favour of Vornado in respect of its purchases and sales of Sears Canada shares because the existence of the Release was not a material fact.

[183] Similarly, they maintain that they were not obligated to disclose the fact that Support Agreements with Scotia Capital and BNS had been signed "in escrow" because, until such time as the Minority Condition was satisfied, the Support Agreements were not binding and, if the Minority Condition was never satisfied, the Support Agreements would be deemed not to have been delivered. Sears Holdings maintains that disclosure that the Support Agreements had been signed in escrow by BNS and Scotia Capital would have been misleading to the market given that there was no assurance that the Minority Condition would be satisfied and this information was withheld "in order to protect minority shareholders from tendering under a misapprehension."

[184] Sears Holdings submits that it had no obligation to disclose the identity of the parties to the Support Agreements on the basis that this information "was not, in any sense, material to shareholders."

[185] Counsel for Sears Holdings submitted in his closing submissions that the tax impact of the extension of the Offer that resulted from the Support Agreement negotiations as well as the "stop-

loss" aspect of the *Income Tax Act* were, in fact, properly disclosed and that shareholders were, as is customary, advised to consult with their own advisors.

[186] With regard to the failure to mention the price protection provided to Natcan when the lock-up agreement was first disclosed in connection with the announcement of the Offer, counsel for Sears Holdings submits that whether or not a particular term of an agreement ought to be disclosed is "a matter of business judgment." In addition, they say, the price protection provided to Natcan was ultimately disclosed in the Bid Circular.

[187] Full, accurate and timely disclosure is a fundamental underpinning of Ontario securities law. In a take-over bid context, a principal means of protecting the bona fide interests of the shareholders of target companies is by ensuring that they are provided with information that might reasonably affect their decision to accept or reject a bid for their shares. Information is material, and therefore should be disclosed, if there is a substantial likelihood that a reasonable shareholder would consider it important when deciding whether to accept or reject the bid. This determination involves more than the application of "appropriate business practices or judgment." (*Re Maple Leaf Sports & Entertainment Ltd.* (1999), 22 O.S.C.B. 2027; *Beringer Properties Inc.*, (1993) 18 B.C.S.C. Weekly Summary 18 at 22; and *Re Standard Broadcasting Corp. Ltd.* (1985), 8 O.S.C.B. 3672 at 3676-3677).

[188] In his closing submissions, counsel for Sears Holdings referred us to the *MacDonald Oil* case where the Commission, in its reasons, indicated that it is often the case that allegations of non-disclosure or inadequate disclosure are made during the course of a take-over bid. They further noted that "there is a difference between perfect disclosure, which no two opposing counsel likely would ever agree upon, acceptable disclosure and material non-disclosure or materially misleading disclosure." Counsel submitted, and we agree, that this is a sensible framework against which to assess the Pershing Group's allegations of non-disclosure in this case (*Re MacDonald Oil Exploration* (1999), 22 O.S.C.B. 6453).

[189] To the sensible framework laid out by the Commission in the *MacDonald Oil* case, supra, we would add that there is also a difference between disclosure which strictly follows the "line items

requirements" in a form or a rule and disclosure that focuses on information that may be material to an investor's decision to tender their shares to a bid in the particular circumstances. Sears Holdings' defence of their disclosure approach in the context of their insider bid rests upon the absence of a specific line item obligation to disclose coupled with their view that the information was not likely to be important to investors in determining how to respond to the Offer.

[190] No-one should be held to a standard of infallibility when it comes to judging disclosure with the benefit of hindsight. However, meeting one's disclosure obligations is a contextual, and not purely mechanical exercise, and requires the exercise of judgment. In the context of a bid, the success of which is conditional upon a particular shareholder tendering his shares or agreeing to vote in favour of a SAT, tentative agreements with that shareholder are fundamentally important and should be disclosed. Sears Holdings' defence that there is no general obligation to disclose the identity of shareholders who choose to tender to a bid is not an appropriate analogy. A deal with an individual shareholder to support a SAT in the midst of a bid that otherwise appeared to be failing is unusual and cannot be equated with an anonymous decision on the part of a shareholder to tender to the bid. The identity of the counterparties to the Support Agreements was material information in these circumstances and ought to have been disclosed. That the counterparties may have preferred for this information to be kept confidential would not relieve Sears Holdings of any disclosure obligation that they might have had.

[191] With regard to the confidentially provisions in the Support Agreements, the evidence we heard conflicted to a certain extent. On the one hand, Mr. Crowley of Sears Holdings testified that the confidentiality provisions were added to the Support Agreements by counsel acting on behalf of BNS and Scotia Capital. The impetus for their inclusion did not come from Sears Holdings. Mr. O'Donnell of BNS did not dispute this. However, Mr. O'Donnell indicated that, notwithstanding BNS's earlier insistence on inclusion of the provision, continued confidentiality was not critical from their perspective. As speculation and interest in knowing the identity of the counterparties to the Support Agreements mounted in the press and elsewhere, BNS apparently communicated to Sears Holdings their willingness to have their identity revealed. In fact, we heard evidence that it was Mr. Frank Switzer, an official spokesperson for BNS, who first confirmed in an April 12 Wall Street Journal article that the Bank was a party to the Support Agreement.

[192] The fact that the Support Agreements were being held in escrow and subject to the Minority Condition does not necessarily mean that their existence could not have been disclosed, together with the necessary disclosure about the conditions to which they were subject so as to ensure that they would not be "misleading to the marketplace". Indeed, as both the Pershing Group and Commission Staff pointed out, in the April 4, 2006 Notice of Extension and Variation, Sears Holdings certified that there were "no contracts, arrangements or understandings" between it and any security holder in relation to the Offer although there was such an arrangement, albeit conditional and held in escrow. This certification did not accurately and fairly reflect the reality at the time. Counsel for Sears Holdings said in closing submissions: "Those Support Agreements, the signed documents that later became the Support Agreements, simply did not exist until the escrow condition was satisfied." (emphasis added). We reject this characterization. There is no basis in fact or logic for us to conclude that the heavily negotiated, signed Support Agreements did not exist simply because they were subject to a condition pre-requisite to their release and effectiveness.

[193] The evidence showed that the Vornado Release, regardless of any lack of importance that Sears Holdings may have attached to it, was of critical importance to Vornado. This, too, was material information that might have provided more objective information to other shareholders with which to assess the import of the Vornado Agreement.

[194] Similarly, the Sears Holdings press release of December 5, 2005, announced that it had entered into a lock-up agreement with Natcan pursuant to which Natcan "has agreed to tender all 9,699,862 shares that it owns or controls in response to Sears Holdings' Offer". Shareholder and marketplace assessment of an independent third party agreement to tender to Sears Holdings' Offer at $16.86 per share might well have been impacted had they known that Natcan had received 3 month price protection under the terms of the lock-up agreement.

[195] The Pershing Group has urged us to conclude that the public disclosure of Sears Holdings in the circumstances of this case was woefully inadequate, self-serving, and sometimes misleading. They maintain, and Commission Staff agree, that decisions with respect to disclosure appear to have been made for tactical purposes, to advance the self interest of Sears Holdings rather than to ensure that the investing public received proper and timely disclosure.

[196] Viewed as a whole, the panel is troubled by the approach taken by Sears Holdings to their disclosure obligations in the context of their Offer. Insider bids are subject to the rigorous disclosure, valuation, majority of the minority shareholder approval and Special Committee requirements which are the protective pillars so central to Rule 61-501. These protections are intended to safeguard the rights and interests of minority shareholders in circumstances where related party transactions are undertaken, such as the insider bid in question. Insiders such as Sears Holdings must ensure that they treat minority shareholders fairly and comply fully with the spirit and intent of their disclosure and other obligations. We are particularly troubled by Sears Holdings' approach with respect to making proper and timely disclosure to the Special Committee of Sears Canada. Our concerns with regard to interactions between Sears Holdings and the Special Committee extend beyond the failure to provide the Committee with the disclosure and information they sought in order to properly fulfill their mandate. We address these latter concerns in detail later in these Reasons.

[197] In their written submissions, Sears Holdings maintains that even if we were to find that they fell short of their disclosure obligations, the remedy originally sought by the Pershing Group of cease trading the Offer or excluding from the minority the shares held by the parties to the Vornado Agreement and the Support Agreements would be disconnected from, and disproportionate to, the wrong alleged. On balance, we agree that such relief would be disproportionate in the circumstances. We also note that the revised draft relief which the Pershing Group presented for our consideration at the hearing did not include a request that we generally cease trade the Offer. Although a "compliance order" pursuant to section 104 of the Act is subject to the inherent limitations of addressing disclosure deficiencies on an ex post facto basis, we have concluded that this is the most appropriate and proportionate remedy available to us in relation to the disclosure deficiencies. At the same time, such an Order, considered in conjunction with these Reasons, will signal to the marketplace more generally the importance of complying with the spirit and intent, as well as the form, of our disclosure requirements.

D. Did the Support Agreements and the Vornado Agreement Contravene Subsection 97(2) of the Act?

The Legislative Scheme

[198] Subsection 97(1) of the Act sets out the basic requirement that, where a bid is made, all of the holders of the same class of securities must be offered identical consideration.

[199] Subsection 97(2) of the Act prohibits an offeror making or intending to make a take-over bid from entering into "any collateral agreement, commitment or understanding with any holder of beneficial owner of securities of the offeree issuer that has the effect of providing to the holder or owner a consideration of greater value than that offered to the other holders of the same class of securities."

[200] Subsection 97(3) of the Act provides that, where the terms of take-over bid are varied prior to its expiration so as to increase the value of the consideration offered for the securities subject to the bid, the offeror must pay the increased consideration to each person or company whose securities are taken up pursuant to the bid, including those whose securities were taken up prior to the variation.

(i) What Are the Elements of the "Collateral Benefits" Prohibition?

[201] Although the use of the term "collateral benefit" does not, in fact appear in the actual text of the legislative prohibition in subsection 97(2) of the Act, it is the descriptive title which appears before the section and is often used to describe the prohibition enshrined in subsection 97(2). For purposes of these Reasons, we use the term "Collateral Benefits Prohibition" in referring to the subsection 97(2) prohibition.

[202] In order for there to be a violation of subsection 97(2) of the Act, two conditions must be met:

a. there must be a collateral agreement, commitment or understanding between the

offeror and a shareholder: and

b. such agreement, commitment or understanding must have the effect of providing the shareholder with consideration of greater value than that offered to other shareholders of the target corporation.

[203] As regards the first condition, the Commission has described a "collateral agreement" as: "…an agreement separate and apart from any agreement resulting from acceptance of the offeree's take-over bid itself…The primary dictionary meaning of collateral is "running side by side – parallel." (*Re Genstar Corp.* (1982) 4 O.S.C.B. 326C at 338C).

[204] In this case, there is no dispute between the parties that the Vornado Agreement and the Support Agreements satisfy the first branch of the two-part test in the Collateral Benefits Prohibition.

[205] The issue in dispute is whether the Vornado and Support Agreements had the effect of providing to the shareholders that were parties to them consideration of greater value than that which was offered to other shareholders of Sears Canada.

(ii) The Vornado Agreement

[206] On April 1, 2006, Sears Holdings entered into its deposit agreement with Vornado (the Vornado Agreement) under which Vornado agreed to deposit its 7.5 million shares of Sears Canada to a revised Offer of Sears Holdings at a price of $18.00 per share. Sears Holdings agreed to pay Vornado, and all other Sears Canada shareholders whose shares are taken up under the Offer including those shareholders who had already tendered their shares to the Offer, any increased consideration paid by Sears Holdings either under the Offer or any subsequent acquisition of all Sears Canada shares prior to December 31, 2008, under the Deposit Agreement (Price Protection). Sears Holdings also provided the following release to Vornado (the Release):

> "In consideration for entering into (the Deposit Agreement), Sears Holdings Corporation…hereby releases Vornado Realty L.P….(and their respective officers, directors, employees and agents) from any and all claims and demands of any nature arising out of or otherwise based upon the activities of Vornado…in connection with Vornado Realty L.P.'s acquisition and disposition of Common Shares of Sears Canada Inc. and entering into and performing this Agreement…In addition, Sears Holdings Corporation agrees….to cause Sears Canada Inc. to execute an instrument expressly agreeing to this release on behalf of itself and its subsidiaries."

[207] Sears Holdings did not disclose this Release when it publicly announced the Vornado Agreement nor did it do so in its Notice of Extension and Variation dated April 4, 2006. The existence of the Release was first disclosed by Sears Holdings on June 10, 2006, in the course of carrying out its production obligations in connection with these proceedings.

Arguments, Law and Analysis

[208] The Pershing Group submits that consideration of greater value has been provided to Vornado in the form of the Release and that this consideration has not been offered to other shareholders of Sears Canada. On its face, the granting of the Release in favour of Vornado pursuant to its Deposit Agreement with Sears Holdings therefore contravenes subsection 97(2) of the Act. The onus, they argue, then shifts to the offeror to demonstrate that the special features of the arrangement, in this case, the Release, did not give rise to consideration of greater value than was offered to the other shareholders (*Re Royal Trustco Ltd. and Campeau Corporation* (No. 2) (1980), 11 B.L.R. 298 at 309).

[209] Sears Holdings' disputes that the Release has the effect of providing consideration of greater value to Vornado than that which was offered to other shareholders. They say that, as Sears Holdings did not believe that either it or Sears Canada had any private cause of action against Vornado in any event, granting Vornado the Release did not have the effect of providing Vornado with anything of value.

[210] Although Sears Holdings may not have attached any value to the Release, the evidence at the hearing during the cross-examination of Mr. Crowley clearly established that Vornado attached significance to the Release. Mr. Crowley confirmed that Mr. Roth, Chairman of Vornado, was directly involved in discussions with Mr. Lampert relating to the scope of the Release. As neither Mr. Roth nor Mr. Lampert were called as witnesses at the hearing, we do not know what the precise nature of those discussions were but Mr. Crowley suggested in his evidence that successfully negotiating the form and wording of the Release was important to Vornado in causing it to enter into the Deposit Agreement. He indicated that Vornado was originally negotiating for a broader form of indemnity but ultimately agreed to the Release.

[211] The Pershing Group, in its written submissions, referred to the following statement by Mr. Roth in connection with Vornado's Annual Report for 2005:

> "With respect to Sears Canada, sure there's more value there than the offered price, but we made a fine profit here and fighting for a few more bucks is not our game. In this case, we'll leave that to others. Our shares have been tendered and taken up, we have received our $118 million in cash and enjoy price protection through December 31, 2008."

[212] As we have previously noted in connection with Sears Holdings' allegations against the Pershing Group, if the Pershing Group was found to be a joint actor with Vornado in connection with its purchases of Sears Canada shares, the corollary would also have been true although it was not alleged. We do not know, and cannot speculate, as to whether this played any role in the negotiations between Mr. Roth and Mr. Lampert in connection with the Deposit Agreement.

[213] The law provides that, for purposes of subsection 97(2), it is not necessary to determine whether the quantum of the consideration is large or small. (*Royal Trustco Ltd.*, supra).

[214] In the *CDC Life Sciences* case, the Commission held that, even in the face of conflicting evidence about value, value can be inferred from the very fact that a shareholder entered into an agreement. Specifically, the Commission stated in its decision that it was "confident that the

(security holder) would not have entered into the agreement unless it saw some value to itself in so doing." (*Re CDC Life Sciences Inc., Caisse de depot et placement du Quebec and Institut Merieux S.A.* (1988), 11. O.S.C.B. 2541 at 2554).

[215] In the *Olympia and York* case, the British Columbia Securities Commission explicitly recognized, by granting an exemption from a Collateral Benefits Prohibition equivalent to subsection 97(2) in respect of an indemnity against legal liability that had been provided to a shareholder, that benefits of this nature are otherwise prohibited (*Re Olympia & York Developments Ltd.,* (1989) B.C.S.C. Weekly Summary 131).

[216] We have concluded that the granting of the Release in connection with the Vornado Agreement constituted a violation of subsection 97(2) of the Act. On its face, it constitutes consideration of greater value than that offered to other shareholders of Sears Canada in connection with the Offer and Sears Holdings has not discharged the burden of persuading us that it did not provide consideration of greater value than that offered to other shareholders of Sears Canada.

[217] In coming to this conclusion we have considered Sears Holdings' argument that, as they did not consider the Release to have any value, Sears Holdings could not have contravened subsection 97(2) of the Act by providing it. To accept this argument would be to concede that the offeror's subjective assessment of the value of the consideration provided, or in this case the alleged lack thereof, is determinative.

[218] The Canadian Oxford Dictionary defines consideration, in a legal context, to mean "anything given or promised or forborne by one party in exchange for the promise or undertaking of another." The Black's Law Dictionary similarly provides that consideration means "something (such as an act, a forbearance, or a return promise) bargained for and received by a promisor from a promisee". In both cases, the concept of "forbearance" is relevant.

[219] The law is well settled that "forbearance to sue is good consideration." Even where the validity of a claim is in doubt, the courts have held that forbearance to enforce it can be good consideration." (*B. v. Arkin* (1996), 138 D.L.R. (4th) 309 (Man. Q.B.) at 313 and 314).

[220] In this case, the Release that was provided gave Vornado comfort that Sears Holdings would "forbear" from suing Vornado in connection with its purchases and sales of Sears Canada shares. It went further in also providing Vornado with Sears Holdings' commitment to secure the same release from Sears Canada in favour of Vornado (although we were advised during the hearing that this release had not yet been executed by Sears Canada). This Release is presumed to have value and constitutes consideration of greater value than that offered to other minority shareholders who have not received such a release.

(iii) The Support Agreements

[221] The facts relating to the ownership of the Sears Canada shares to which the Support Agreements relate were not contested. Briefly, Scotia Capital IEG purchased, for risk arbitrage purposes, 513,000 Sears Canada shares between August 31, 2005 and December 16, 2005. BNS, through Scotia CMG, acquired 4 million Sears Canada shares as a partial hedge against the swap agreements it had entered into with SunTrust and a broker dealer and hedged the rest of its exposure under the swap agreements by entering into offsetting swaps. RBC owns 3.9 million Sears Canada shares and also entered into various equity swap agreements.

[222] The BNS Support Agreement relates to the 4 million Sears Canada shares owned by BNS. The Scotia Capital Support Agreement relates to 511,000 of their Sears Canada shares. The RBC Support Agreement relates to 3.1 million of the 3.9 million shares owned by RBC. In the aggregate, the Support Agreements covered approximately 7.1% of the then outstanding Sears Canada shares.

[223] From the time that Sears Holdings first announced their Offer in early December, 2005, BNS and RBC (referred to collectively as the Banks), as Canadian corporate shareholders, were aware of the potential impact of the Offer on their tax position. Once the Offer came to the attention of Mr. O'Donnell of BNS CMG, he wrote to his colleague Mr. Chris Purkis to raise awareness of the potential impact of the Offer on BNS. Thereafter, they began to consider and discuss strategies to improve the tax treatment on the taxable dividend BNS had received in December, 2005, including negotiating an exit strategy with Sears Holdings which would permit BNS to hold its Sears Canada

shares for more than one year. In paragraph 25 of his Affidavit, Mr. O'Donnell said: "We recognized that we may have to negotiate to have the bid re-structured and extended in order to achieve this objective." Similarly, the potential impact of the Offer was also apparent to RBC as evidenced by the following e-mail from Mr. Richard Tavoso of RBC:

> "…The current takeover for us is negative in that it will force the stock to stop trading and we will not be able to age our inventory for one year in order to qualify for a tax gross-up. We believe there are certain ways the company can structure the deal so that its shareholders can qualify for a tax gross-up and would like to talk to the company and see if they are amenable…."

[224] The tax impact of the Offer that was of concern to the Banks arose from the payment of the extraordinary cash dividend to all Sears Canada shareholders on December 14, 2005. Briefly, under the "stop loss" rules contained in the *Income Tax Act*, tax losses cannot be deducted where tax free dividends have been received and the shares in question have been held for less than 365 days from the date of purchase. Accordingly, if the SAT were to have been successfully completed before December, 2006, the Banks would not have held their shares for more than 365 days and the stop loss rules would therefore apply to the disposition of their shares. In addition, under either of the two forms of SAT preferred by the Banks, they would be able to elect deemed dividend treatment on the disposition of their Sears Canada shares.

[225] Following inquiries, Scotia M & A reported to Sears Holdings and their counsel as to the identity of the banks that owned significant blocks of shares of Sears Canada. The Banks were the only Canadian financial institutions identified as having significant holdings. Sears Holdings realized that the Banks would have an incentive <u>not</u> to tender their shares to the Offer prior to the one-year anniversary of their acquisition because it would result in less advantageous after tax positions as compared to their tax position if they continued to hold the shares until at least December 2006. Based on this assessment, Sears Holdings approached BNS, Scotia Capital and RBC to determine if there was a way in which these parties would be prepared to either tender their shares to the Offer or agree to vote their shares in favour of the SAT.

[226] Following extensive negotiations, by March 28, 2006, Sears Holdings reached an agreement with BNS and Scotia Capital as to the terms of the Support Agreements. However, neither BNS nor Scotia Capital were willing to deliver a binding support agreement until each of them was certain that Sears Holdings had obtained sufficient shares, either pursuant to the Offer or through support agreements negotiated with other parties, to ensure that Sears Holdings would obtain the votes of a majority of the minority shareholders in the SAT (the Minority Condition). Accordingly, the signed Support Agreements were held in escrow.

[227] During the week of April 3, 2006, Sears Holdings continued its negotiations with RBC and, on April 5, 2006, Sears Holdings entered into the Support Agreement with RBC. At that point in time, and in light of the Vornado Agreement, the Minority Condition was satisfied and the Support Agreements executed with BNS and Scotia Capital were released from escrow and became effective agreements.

[228] The Banks both filed materials in aid of establishing the quantum of the tax advantage to each of them as a result of their successful negotiations with Sears Holdings which resulted in an extension of the expiry date of the Offer and negotiation of the precise form of the SAT out of the four possible forms of SAT initially identified in Sears Holdings' Circular. According to BNS and Scotia Capital, the tax benefits were approximately $39.67 million in relation to the 4 million shares held by Scotia CMG if those shares were disposed of in accordance with the Support Agreements. According to the memorandum of Brad Rowse, Senior Vice president, Taxation on March 30, 2006 these benefits would result from a combination of the elimination of the "stop loss' rule by extending the SAT to December 2006 ($16.07 million) and the election to dispose of shares to Sears Canada ($23.60 million). In addition, the per share tax benefit to Scotia IEG in relation to their 511,000 shares would be comparable. According to a letter filed by counsel to RBC, their tax position was as follows: if RBC sold the 3.1 million shares referenced in the Support Agreement before December 9, 2006, RBC would be obliged to pay approximately $15,339,000 of tax referable to the extraordinary dividend paid in December, 2005. This is in addition to an additional $19,307,000 of tax that it would not be obliged to pay were it to dispose of its shares in a re-purchase by Sears Canada at any time after December 9, 2006.

[229] Under the terms of the Support Agreements, BNS, Scotia Capital and RBC each agreed to vote the Sears Canada shares in favour of the SAT and Sears Holdings, in return, agreed that:

(a) the meeting of Sears Canada shareholders to approve the SAT would be held, and any court approval obtained, prior to November 15, 2006;

(b) the SAT would be completed and closed between December 14 and 17, 2006;

(c) the SAT would take the form of either a reverse stock split or consolidation of Sears Canada shares or a plan of arrangement under section 192 of the *Canada Business Corporations Act*; and

(d) in the event that the SAT was not completed by December 15,2006, or December 17, 2006 (as per the BNS/Scotia Capital and RBC Support Agreements respectively) Sears Holdings would consult with BNS, Scotia Capital and RBC as to what future steps should be taken to enable them to dispose of their Sears Canada shares (the Liquidity Consultation Provision).

[230] The quid pro quo for the Banks entering into the Support Agreements was Sears Holdings' agreement to revise the Offer and the SAT to accommodate their tax planning objectives. Specifically, the changes to the Offer were as follows:

(a) the expiry date of the Offer was extended to August 31, 2006 and the SAT was deferred to December 2006 (the Offer Extension) as a result of which the Banks were able to preserve a significant tax loss deduction in connection with their Sears Canada shares; and

(b) the narrowing down of the SAT to one of two forms of transaction out of the four possibilities originally identified by Sears Holdings in their Circular, which would be treated as a redemption for tax purposes from the perspective of the Banks which, in turn, would result in a substantial tax free deemed dividend to BNS, Scotia Capital and RBC (the SAT Election).

Arguments, Law and Analysis

[231] Sears Holdings argues that, upon completion of the SAT in December, 2006, the consideration that will have been paid to all minority shareholders of Sears Canada under the Offer will be $18.00 per share. In other words, the Support Agreements (and the Vornado Agreement) will not have the "effect" of providing consideration of greater value to the Banks (and Vornado) than was offered to the remaining minority shareholders of Sears Canada. We accept the first part of this submission inasmuch as all shareholders will receive $18.00 per share under the Offer and upon successful completion of the SAT. In other words, all holders of the same class of securities are being offered identical consideration under the Offer as required by subsection 97(1) of the Act.

[232] The Pershing Group's allegation is that the effect of entering into the Support Agreements was to provide the Banks with consideration of greater value than that offered to other shareholders in violation of subsection 97(2) of the Act. Counsel for the Pershing Group characterized the arguments made on behalf of itself and Sears Holdings as "two ships passing in the night. We are arguing a 97(2) case and they are arguing 97(1)." Subsection 97(2) of the Act establishes an "effects based" test for determining whether a collateral agreement, commitment or understanding has been entered into in violation of its provisions.

[233] Sears Holdings and the Banks argued several points with regard to whether the tax advantages that are available to the Banks as a result of the successful negotiation of the revised terms of the Offer and SAT violate the Collateral Benefits Prohibition. They say that some other shareholders may well be in the same position as the Banks and will be able to benefit from the same revised terms of the Offer by holding on to their shares and voting in favour of the SAT as the Banks have agreed to do. The difficulty we have with this argument is that the evidence clearly shows that millions of shares traded during the period between the commencement of the Offer and the revised Offer being announced. Even if we accept, as we do, Sears Holdings' argument that it is for the individual shareholders of Sears Canada to determine their own financial and tax position with regard to the Offer and the SAT, the fact that the revised Offer followed months of extensive trading in the shares of Sears Canada after commencement of the bid is fatal to the argument that other

shareholders of Sears Canada who are in a similar tax position to the Banks have the same opportunity to benefit from the revised Offer. As counsel for Pershing put it in his closing submissions, "They can't take 25 million pieces of toothpaste and stick them back in the toothpaste tube, because that is how many shares have traded in the time the bid was pending."

[234] The submissions from the Banks and Sears Holdings emphasized that both subsections 97(1) and 97(2) of the Act focus on the consideration offered under the bid and not on the after-tax impact of the consideration received by individual shareholders. It is, of course, true that the after-tax impact of the consideration ultimately realized pursuant to the Offer or upon successful completion of the SAT will vary across the diverse shareholder base depending on whether the shareholder is an individual, corporation, tax exempt entity or even a resident of Canada. In his Affidavit, Mr. Crowley stated as follows:

> Throughout his Affidavit, Mr. Ackman emphasizes that the Support Agreements were negotiated with a view to the tax position of BNS, Scotia Capital and RBC. This is certainly the case. There was nothing even remotely improper in Sears Holdings taking into account the tax position of shareholders of the target corporation in determining how to make the proposed acquisition the most appealing to holders of the largest number of shares. This is a common factor taken into account by offerors and it would have been irrational for Sears Holdings not to do so.
>
> (Affidavit of Mr. William C. Crowley sworn June 21, 2006 at para. 101).

[235] We agree entirely with these submissions. Section 97 of the Act cannot be interpreted to mean that all holders of the same class of securities must be offered identical after-tax consideration or that bidders are required to adjust the consideration offered to account for the unique tax positions of diverse groups of shareholders. In fact, offerors are required to provide adequate disclosure of the tax consequences of an Offer precisely to allow shareholders to assess the impact of the Offer on their own tax position and take this into account in deciding whether or not to tender, participate in the SAT or exercise any other rights that may be available to them. As a general proposition, there is nothing wrong with bidders taking into account the tax planning objectives of shareholders

generally in the course of structuring their bids. Clearly, the Act cannot and should not be interpreted so as to require offerors to provide identical consideration to shareholders on a post-tax basis. This would be neither practical nor sensible.

[236] The Pershing Group relied upon two previous Commission decisions in support of their position that "tax benefits" can be found to violate the Collateral Benefits Prohibition.

[237] In the *Royal Trustco Ltd.* case, Campeau made an all-cash bid for the common and preferred shares of Royal Trustco. Prior to launching the bid, Campeau had obtained a call option on the Royal Trustco shares owned by Unicorp in consideration for which Unicorp received convertible preference shares of Campeau which, on the third anniversary date from issuance, would automatically convert into common shares of Campeau. Unicorp also entered into a shareholders' agreement with Campeau's principal shareholder which would allow Unicorp the option of either selling its convertible preference shares to, or buying Campeau common shares from, the principal shareholder. Campeau apparently applied for relief from the Collateral Benefits Prohibition but withdrew its application prior to the conclusion of the hearing. The Commission found that the call option and shareholders' agreements made it possible for Unicorp to receive advantages or benefits that were not offered to other shareholders of the same class in the form of a "tax-free rollover of its Royal Trustco shares into Campeau shares." The Commission stated in its decision that "the onus was on Campeau to demonstrate that the special features of the arrangement with Unicorp did not give rise to consideration of greater value than that offered the other shareholders of the class." The Commission ultimately found that Unicorp did not receive the same consideration as other Royal Trustco shareholders and that the call and shareholders' agreements constituted Prohibited Collateral Benefits. (*Royal Trustco Ltd.*, cited above, at page 309).

[238] Sears Holdings and the Banks argue that the conclusions reached by the Commission in the *Royal Trustco Ltd.* case are not applicable in this case as they are limited to a situation in which the bidder provides certain shareholders with a different form of consideration than that offered to other target shareholders. In this case, all Sears Canada shareholders are being offered the same consideration of $18.00 per share. While the Royal Trustco situation is not on all fours with this case, it is relevant in establishing that the onus rests with Sears Holdings and the Banks to establish

that the special features of the Support Agreements do not "give rise to consideration of greater value than that offered the other shareholders" of Sears Canada.

[239] In the *Noranda case*, the Commission gave relief from the Collateral Benefits Prohibition. In that case, the target shareholders were given the option of receiving cash or voting preferred shares redeemable for the same amount as the cash consideration. The preferred share option provided the controlling shareholders with favourable tax treatment. Although all shareholders were given the same choice between cash or preferred shares, the controlling shareholders were the only shareholders who would stand to realize a tax advantage in choosing the preferred share option. For this reason, an order from the Commission was sought. While the *Noranda* case is, again, not on all fours with the instant case, it establishes that a bidder that seeks to accommodate the specific tax planning objectives of certain target shareholders (in that case, the controlling shareholders) in preference to other shareholders may well be considered to have violated the Collateral Benefits Prohibition. In *Noranda*, all target shareholders were given the same choice of cash or preferred shares redeemable for the same amount as the cash consideration. However, the controlling shareholders were the only parties who were in a position to realize a tax advantage from the preferred share option. Similarly, in this case, Sears Holdings and the Banks argue that all minority shareholders are being offered the same revised Offer as the Banks. The practical reality is that the Banks may well be the only shareholders who can take advantage of the tax benefits that will be available to them as a result of the negotiation of the revised terms of the Offer and the SAT mid-bid and neither Sears Holdings nor the Banks have established otherwise. These arguments are not, in any event, dispositive in determining the application of the Collateral Benefits Prohibition to the Support Agreements in these circumstances.

[240] Counsel for RBC argued that, with the exception of the *Noranda* case, none of the authorities or precedents addressed the situation where the alleged benefit does not emanate from the bidder directly but, rather, follows from the application of general tax laws to the particular circumstances of a shareholder. Counsel for Sears Holdings made a similar submission in which he argued that the concept of "consideration of greater value" which is central to the Collateral Benefits Prohibition under subsection 97(2) must emanate from the offeror. Our finding with regard to whether or not the Support Agreements had the effect of providing consideration of greater value to the Banks than

to other shareholders of Sears Canada does not depend on this interpretive issue as will be clear from our reasoning below. However, we note that the Collateral Benefits Prohibition does not expressly require that the consideration of greater value, if it is found to exist, must emanate from the offeror or the person acting jointly or in concert with the offeror. Rather, the Collateral Benefits Prohibition requires a determination of whether a collateral agreement, commitment or understanding has the "effect" of providing to a shareholder consideration of greater value than that offered to other shareholders.

[241] The *Royal Trustco Ltd.* case, supra, is helpful in addressing a further interpretive issue that was raised in connection with the ambit of subsection 97(2) of the Act. Section 97 applies to take-over bids as defined. A take-over bid is defined in subsection 89(1) of the Act as "an offer to acquire …securities…". The *Royal Trustco Ltd.* case established that agreements which confer collateral benefits on shareholders even though they contemplate the acquisition of shares outside of a bid are still subject to subsection 97(2) of the Act. In that case, the Commission found that there was a prohibited collateral benefit where the offeror proposed to acquire shares outside of a bid pursuant to a call agreement. As a matter of principle and policy, it should not be possible for an offeror to avoid the application of the Collateral Benefits Prohibition by agreeing to provide collateral benefits to a shareholder whose shares are to be acquired outside the bid in a SAT or other transaction. There is nothing in the language of subsection 97(2) which expressly requires or even implies that the shares at issue must be acquired under the bid. To interpret the provision otherwise where avoidance of its intent could so easily be achieved would be to undermine the fundamental principle of equal treatment of shareholders. We also note that it would be inconsistent with Rule 61-501 which treats the combination of the Offer and the SAT as the equivalent of a single transaction for purposes of determining whether the Minority Approval requirement has been satisfied.

[242] As noted above in the context of the consideration of the Vornado Agreement, consideration is not a defined term under the Act. In the case of *Currie v. Misa*, an English court provided a definition of consideration which has frequently been cited with approval by courts in Canada. It was said to consist in "some right, interest, profit or benefit accruing to the one party or some forbearance, detriment, loss or responsibility, given, suffered, or undertaken by the other." (*Currie v. Misa* (1875), L.R. 10 Exch. 153; affirmed (1876), 1 App. Cas. 554 (H.L.). Consideration has

been held by the courts to mean something which is of value in the eyes of the law and could include an act, or promise of an act, which is incapable of being given a monetary value, though it has some value or benefit in the sense of advantage for the party who is the present or future recipient or beneficiary of the act. (*Thomas v. Thomas* (1842), 2. Q.B.851 at 859; *Meisner v. Bourgaux Estate* (1994), 131 N.S.R. (2d) 244 (N.S.S.C); *Bank of Nova Scotia v. MacLellan* (1977), 78 D.L.R. (3d) 1 (N.S.S.C)).

[243] Commission Staff take the position that the Support Agreements violate the Collateral Benefits Prohibition. They reject the arguments of Sears Holdings and the Banks to the contrary for a number of reasons including the following:

- Sears Holdings took into account the tax objectives of a select group of Sears Canada shareholders whose votes it required and not those of all other shareholders;

- if the Collateral Benefits Prohibition were to be interpreted as focusing only on the identical consideration issue, this would make subsection 97(1), which sets out the basic requirement for identical consideration, superfluous; and

- it is clear from the evidence that the Banks would have suffered severe tax losses if the Offer and the SAT had been completed within the timeframe and in the form originally contemplated by Sears Holdings and if Sears Holdings had chosen not to enter into the Support Agreements and had simply raised the bid price under the Offer.

[244] Counsel for the Pershing Group submits that, at the end of the day, the effect of the Support Agreements was to do exactly what subsection 97(2) of the Act is directed at preventing. The Banks agreed to support the SAT in circumstances where they would not, in fact, have tendered to the bid because they received consideration of greater value in exchange for entering into the Support Agreements.

[245] We agree. The consideration of greater value that was received by the Banks in this case consisted of the promise of the Offer Extension, the SAT Election and the Liquidity Consultation

Provision which, in turn, ensured that the Banks would be in a position to preserve and realize millions of dollars worth of tax benefits. By entering into the Support Agreements, the Banks were able to negotiate these revised terms of the Offer which ensured that they would not be forced to tender into the bid prior to December, 2006 and thereby lose these tax benefits. By entering into the Support Agreements, the Banks were able to ensure that the form of the SAT, which would otherwise have been at the option of Sears Holdings to choose from among the four possibilities outlined in the Bid Circular, was one which would be advantageous to the Banks from a tax point of view. The Support Agreements also provided the Banks with the benefit of the Liquidity Consultation Provision, described above, which was not available to other shareholders of Sears Canada. This commitment on the part of Sears Holdings to consult with BNS, Scotia Capital and RBC as to future steps that might be taken to enable them to dispose of their shares in the event that the SAT was not successfully completed by December, 2006, appears to provide consideration of greater value than that offered to other Sears Canada shareholders particularly in light of Sears Holdings' persistent warnings that the Sears Canada shares would be very illiquid upon completion of the Offer. No evidence was offered to the contrary. In return for the Banks support of the SAT, Sears Holdings promised to take the foregoing actions which constituted consideration that was of considerable value to the Banks in ensuring that they would not be effectively forced to tender to the Offer and thereby lose the tax benefits that they wished to preserve and realize.

[246] We have concluded, for the reasons and based on the analysis set out above, that the effect of the Support Agreements was to provide consideration of greater value to the Banks than that offered to other Sears Canada shareholders. We are satisfied that no other conclusion, in the unique circumstances of this case, would be consistent with the wording, spirit and intent underlying the Collateral Benefits Prohibition which is a fundamental element of the protections afforded under Part XX of the Act.

(iv) What is the Appropriate Remedy in Relation to the Vornado Agreement and the Support Agreements?

(a) Extending the Release to Sears Canada Shareholders

[247] Given our finding that the Vornado Agreement contravened subsection 97(2) of the Act, what is the appropriate remedy? Counsel for the Pershing Group submits that the votes attached to the Sears Canada shares acquired by Sears Holdings from Vornado pursuant to the Deposit Agreement ought not to be included in the minority for purposes of the minority approval of the SAT. They say that exemptive relief under subsection 104(2) of the Act could not have been available to Sears Holdings had it been sought as the Deposit Agreement was not made for reasons other than to increase the value of the consideration paid to Vornado.

[248] Sears Holdings submits that the relief sought by the Pershing Group is disconnected from and disproportionate to the alleged wrong. They say that a more appropriate remedy, if one is required at all, would be for Sears Holdings to issue a Notice of Variation pursuant to subsection 98(4) of the Act to extend the same release, in effect, to all other shareholders whose shares are acquired pursuant to the Offer.

[249] Commission Staff maintain that it is unclear how providing a similar release to other Sears Canada shareholders would eliminate the benefit received by Vornado when the release is likely to have greater value for Vornado than any other Sears Canada shareholder.

[250] Deposit agreements, support agreements, and lock-up agreements are all contemplated by the Act and Rule 61-501 and are not, in and of themselves, objectionable or illegal. As counsel for RBC pointed out to us in closing submissions, such agreements are a common and accepted tool for bidders in this jurisdiction. Insider bidders are also entitled to lock-up a majority of the minority votes and to have those votes count in a second stage transaction. Although we must analyze the Vornado Agreement and the Support Agreements separately, they were, as counsel for Sears Holdings put it, in the nature of a "package deal." Another description offered was of a "three legged stool." It was Vornado that was successful in negotiating for an increase in the bid price from $16.86 per share to $18.00 per share. As counsel for Sears Holdings put it in closing submissions: "Mr. Roth knew he had Sears Holdings where he wanted them, and he had the ability

to extract the last nickel out of Sears Holdings, and he did it...And he was probably, in the circumstances, the only person who could have done that."

[251] The remedy we fashion must be preventive and protective in nature and not punitive. In balancing the nature and effect of the collateral benefit provided by Sears Holdings to Vornado, the extent of the preferential treatment afforded to Vornado in the form of the Release, the impact of the granting of the Release on the integrity of the process and shareholder confidence against the increase in the bid price that resulted from the Vornado negotiations to the benefit of all Sears Canada minority shareholders, we are of the view that, in order to address the inherent unfairness of the Release having been granted only to Vornado, Sears Holdings ought to amend the Take-Over Bid Circular in respect of the Offer to disclose the existence and terms of the Release granted to Vornado pursuant to the Vornado Agreement and grant the same Release to other shareholders whose shares were or are acquired under the bid or the proposed SAT.

[252] Vornado clearly negotiated in its own commercial self-interest and the result of that negotiation was a higher bid price that accrued to the benefit of all Sears Canada shareholders including the Pershing Group.

[253] The nature of the collateral benefit that was obtained by Vornado is such that it can feasibly and pragmatically be extended to all shareholders of Sears Canada whose shares were or are acquired under the Offer. We are of the view that extending the release to other shareholders of Sears Canada whose shares are acquired under the bid or under the proposed SAT is appropriate and fair in the circumstances and consistent with the principle of equal treatment of all shareholders under a bid. To do so is also consistent with the animating principle underlying s. 97(3) of the Act.

[254] We are equally of the view, however, that on its own, this remedy is inadequate and fails to redress the real harm which has been done by Sears Holdings in granting the release to Vornado in the context of negotiating the Deposit Agreement. Merely granting the Release to other Sears Canada shareholders will not, of course, result in equal treatment. These shareholders do not have the opportunity that Vornado had to make their decision to tender to the bid conditional upon the receipt of a satisfactory form of Release. From the evidence, we know that receipt of the Release

was important to Vornado in its decision to tender to the bid. Accordingly, we must address the impact, if any, that the tendered Vornado shares ought to have on the minority approval of the SAT required to be obtained in accordance with the terms of Rule 61-501 and its Companion Policy. This matter is addressed immediately below.

(b) The Minority Approval Requirement of Rule 61-501

[255] Our overriding obligation must be to ensure that the consequences to the Offer and the SAT that result from our findings above are consistent with the spirit and intent of the equal treatment requirements which govern insider bids under the Act and consistent with the Minority Approval requirement which is a key protective pillar under Rule 61-501.

[256] The SAT is a business combination under Rule 61-501 because it is a transaction by which Sears Holdings intends to acquire any Sears Canada shares that are not tendered to it under the Offer. The Companion Policy to Rule 61-501 states that the Commission does not consider the types of transactions covered by Rule 61-501 to be inherently unfair. However, the Policy notes that such transactions are capable of being abusive and unfair and that the Commission has therefore adopted the protections set out in the Rule animated by the principles set out in the Companion Policy to Rule 61-501. In order for the SAT to proceed, it must be approved by the minority shareholders in accordance with the provisions of the Rule.

[257] The votes attached to the Sears Canada shares which were tendered to the Offer may generally be included in determining whether Minority Approval of the SAT has been obtained under Rule 61-501 with numerous exceptions. Votes attached to shares of joint actors would have to be excluded. In addition, votes attached to shares of a party that received a collateral benefit under the bid would also have to be excluded. For purposes of Rule 61-501, which focuses on related party transactions, the definition of "collateral benefit" differs from that under the Act and applies to "related parties". The Rule 61-501 definition of "collateral benefit" is not applicable in this case as none of BNS, Scotia Capital, RBC or Vornado are "related parties" as therein defined.

[258] We are therefore left to determine the appropriate remedy based on the application of the policy and principles which underlie the Minority Approval requirement to these circumstances where collateral benefits have been granted to non-related third parties. In responding to comments received on the proposed January 2004 amendments to Rule 61-501, Commission Staff stated as follows:

> In the case of a business combination, where a majority of security holders can force the minority to relinquish their securities against their will, it is important that this majority be comprised, to the extent possible, of security holders who are voting solely on the merits of the business combination. (emphasis added)
>
> (Notice of Proposed Amendments to Rule 61-501 – Insider Bids, Issuer Bids, Going Private Transactions and Related Party Transactions and Companion Policy 61-501 CP (2004), 27 O.S.C.B. 550 at 566).

[259] In its Notice of Amendments to Rule 61-501, in commenting on the nature of the Minority Approval requirement, the Commission expressed the expectation that those voting have interests which are as aligned and as free from conflicts as possible:

> …when a majority vote of security holders can force the minority to relinquish their securities against their will at a price they may regard as inadequate, it is reasonable to require that the security holders comprising the majority be as free from conflicts as possible so that their interests are aligned with those of the minority. (emphasis added).
>
> (Notice of Amendments to Rule 61-501 (2004), 27 O.S.C.B. 4483 at 4486).

[260] In recently introducing the definition of collateral benefits for purposes of Rule 61-501, the Commission noted that collateral benefits can, in fact or perception, induce the recipient shareholders to tender to a bid or to support a business combination. Even where motives are above reproach, the Commission further noted that collateral benefits can cause a transaction to have economic consequences that vary among security holders entitled to vote on the transaction. This can have a distortional impact on the required minority vote.

[261] These principles are applicable in the instant case. It is clear that the Banks agreed to support the SAT in return for the collateral benefits which they received as outlined above. In the case of the Vornado Agreement, we do not know what role the Release played in Vornado's decision to tender to an $18.00 bid price. We know from Mr. Roth's statement in Vornado Annual Report that he believed there was more value there. The result of the Vornado Agreement and the Support Agreements – the "package deal" that Sears Holdings had negotiated with select shareholders – was to ensure the success of the vote on the SAT. This result was prejudicial to the remaining shareholders of Sears Canada who not only had lost their collective leverage with respect to the bid price but also were certain to lose their shares despite how they might otherwise have been inclined to vote on the SAT. We have concluded that, to permit the votes attached to the Vornado shares tendered to Sears Holdings and the votes committed in favour of the SAT under the Support Agreements to count as part of the Minority Approval would be to distort the outcome of the Minority Approval process and vitiate its intended benefit.

[262] Finally, subsection 2.1 (5) of the Companion Policy to Rule 61-501 expressly contemplates the possibility of Commission intervention on public interest grounds where an arm's length security holder is receiving preferential treatment in return for its support of a business combination: "…giving a security holder preferential treatment in order to obtain that holder's support of the transaction will not normally be considered justifiable." Commission Staff submit, and we agree, that the preferential treatment extended by Sears Holdings to the Banks in order to accommodate their legitimate tax planning objectives in the context of a bid that did not otherwise appear to be succeeding affords a basis to conclude that Sears Holdings ought not to be permitted to count the votes in favour of the SAT pursuant to the Support Agreements.

[263] As the Act prohibits agreements with specific shareholders which have the effect of providing consideration of greater value than that offered to other shareholders, we also considered whether to allow the Offer to proceed in circumstances where it has been determined that collateral benefits have been provided to certain shareholders. The Commission may grant exemptions from the Collateral Benefits Prohibition if it is satisfied that it would not be prejudicial to the public interest and the collateral agreement was made for reasons other than to increase the value of consideration

paid for the securities of a selling security holder (subsection 104(2)(a)). This determination would be based primarily on the business purpose for providing the benefit. There was no basis for granting exemptions in this case. However, we decided that a permanent cease-trade order of the Offer would not be an appropriate remedy given the stage of the bid, the nature of the collateral benefits and their effect on other shareholders and taking into account that such a remedy was not put forward by any of the parties, including Commission Staff, in their final submissions to us. In fashioning an appropriate remedy in this case, we are mindful of the challenges we face in attempting to redress various aspects of Sears Holdings' conduct in the pursuit of its Offer given the stage of the Offer and the fact that so many shareholders have already traded or tendered their shares. The Order we are making will ensure that if Sears Holdings does proceed with a SAT, that they must be scrupulous in ensuring that the decision on the SAT is determined by the minority shareholders of Sears Canada uninfluenced by the inclusion of shares or votes secured by conferring collateral benefits and preferential treatment to specific shareholders.

[264] Therefore, we conclude that the Take-Over Bid Circular in respect of the Offer ought to be amended to disclose that Sears Holdings will exclude from the calculation of the majority of the minority, on the anticipated SAT, the shares of Sears Canada acquired by Sears Holdings from Vornado pursuant to the Vornado Agreement and the shares of Sears Canada held by or acquired from Scotia Capital, BNS and RBC, which are the subject of the Support Agreements, including on any other offer or SAT in the future.

E. Was the Conduct of Sears Holdings in Connection with its Offer Coercive and/or Abusive?

[265] The Pershing Group submits that, in considering all of the circumstances of this case, the bid of Sears Holdings is coercive and/or abusive of the minority shareholders of Sears Canada and contrary to the public interest. Counsel for Pershing provided the panel with a summary document enumerating all aspects of the conduct at issue in this matter which they allege, when viewed as a whole, amounts to coercive and abusive conduct. We deal with these complaints below.

[266] Counsel for Sears Holdings urged us to be cautious in applying words like "coercive" and "abusive" to the Offer as these words are often applied loosely and strategically by those who stand in opposition to an offeror and its bid. According to the Webster's Dictionary, "coercive" means to dominate or control especially by exploiting fear or anxiety. The dictionary definition of "abusive" which is relevant in this context means to mistreat. Not surprisingly, previous Commission decisions have not attempted to define these terms in the abstract but rather, have applied the Commission's public interest jurisdiction in the context of particular transactions and circumstances that call out for a remedy. This approach is, perhaps, analogous to the manner in which the Courts have been reluctant to define pornography but, rather, "know it when they see it."

(i) The Absence of a "Minimum Tender Condition"

[267] The Pershing Group takes issue with the fact that the Offer does not contain a minimum tender condition despite the earlier public representation by Sears Holdings to the contrary. They say this is coercive because, in the circumstances, shareholders may well feel pressured to tender for fear of holding shares in an even less liquid post-bid entity.

[268] Sears Holdings submits that their bid is not a partial bid but is, rather, an all-cash premium bid for all outstanding Sears Canada shares and therefore cannot be said to be coercive.

[269] We cannot conclude that the absence of a minimum tender condition is necessarily coercive on its own. There is no obligation to include a minimum tender condition in every offer and nothing, per se, improper with announcing the intention to include such a condition but subsequently deciding not to include it once the bid is formally launched. We also note that even where take-over bids do include such a condition, the condition can typically be waived in the sole discretion of the offeror.

[270] However, liquidity concerns on the part of shareholders who would prefer not to tender to the Offer which lacks the protection of a minimum tender condition can create pressure on shareholders to tender despite their views as to the adequacy of the offer. On its own, this does not warrant

Commission intervention but it is a factor to bear in mind in considering the other claims of coercive or abusive conduct relating to the Offer.

(ii) The Offer Was at a Price Below the Genuity Valuation

[271] There is nothing inherently improper about an offeror deciding to make a bid at a price which is less than the valuation range of the independent valuator. The role of the Commission is not to form an opinion as to the fair value of Sears Canada shares. Similarly, our role is not to weigh in as to the relative merits of the Genuity Valuation or the financial adequacy of the Sears Holdings' bid price. That is for the shareholders of Sears Canada to decide with the benefit of the required valuation and the views of the Special Committee formed pursuant to the requirements of Rule 61-501.

[272] Provided that shareholders have had the benefit of an independent valuation conducted in accordance with the terms of Rule 61-501 and a meaningful opportunity to accept or reject the bid, there is no basis for the Commission to intervene on the basis that the bid is lower than the lowest end of the independent valuation range.

(iii) Interference with the Genuity Valuation Process

[273] Sears Holdings had several meetings with Genuity, organized by the Special Committee, in an effort to ensure that Genuity was aware of information that Sears Holdings believed ought to be considered by Genuity in formulating its valuation opinion. The fact that such discussions took place and that Sears Holdings was desirous of communicating with Genuity prior to completion of the valuation should not be viewed as objectionable or coercive. That such meetings took place would not, absent other conduct, afford a basis to conclude that there was any improper attempt to influence or intimidate Genuity. Proof of the latter would, of course, raise significant concerns.

[274] Following the issuance of the Genuity Valuation, Sears Holdings was openly critical of Genuity, accusing it of having made indefensible assumptions and of ignoring highly relevant

factors which it ought to have considered and which Sears Holdings had brought to its attention. There is nothing wrong with parties disagreeing on the question of fair market value – in fact, this is to be expected. However, the manner in which Sears Holdings chose to attack the integrity of the Genuity Valuation is reflective of the manner in which they dealt with others – such as the Special Committee and the Pershing Group – who got in the way of the successful completion of their bid.

(iv) Decision by Sears Holdings to Cease Dividend Payments

[275] On March 20, 2006, Sears Holdings issued a press release stating that: "in the event that Sears Holdings does not acquire a majority of the minority of Sears Canada shares, Sears Canada will face the increasingly competitive Canadian retail environment without the financial and operating benefits of being owned 100% by Sears Holdings. Therefore, Sears Holdings, consistent with its practice in the United States, will support the elimination of the recent practice of Sears Canada of paying quarterly dividends of C$0.06. In addition, Sears Holdings would not support any extraordinary dividend or distribution to public shareholders in 2006."

[276] Mr. Crowley explained in his Affidavit that Sears Holdings made this public statement of what its intentions were with respect to the payment of dividends. He further explained that Sears Holdings does not pay quarterly dividends and believed that a consistent practice was appropriate for Sears Canada.

[277] Mr. Crowley's characterization of the reasons underlying this public statement by Sears Holdings in the course of its insider bid flies in the face of contemporaneous non-public communications from Mr. Rudka, financial advisor to Sears Holdings, to his colleagues at Scotia Capital. From these e-mails, it is clear that Mr. Crowley intended to use the threat that Sears Holdings would eliminate the Sears Canada dividend in order to exert pressure, or coerce, the shareholders of Sears Canada to tender into the insider bid. The e-mail dated March 13, 2006, from Mr. Rudka to Messrs. Vaux and Asmundson at Scotia Capital states as follows: "Crowley called. …<u>He wants to send out a press release this week reminding people to tender and perhaps threatening no 2006 dividend</u>." (emphasis added)

[278] Sears Holdings followed up on this "threat" by issuing the March 20 press release which announced the intention to eliminate dividend payments at Sears Canada. In so doing, it is noteworthy that Sears Holdings mischaracterized quarterly dividend payments as a "recent practice" when, in fact, Sears Canada had been paying dividends for the past 20 years.

[279] Subsequently, on April 3, 2006, Sears Holdings announced that its Offer had been amended to provide that any dividend paid by Sears Canada after the date of the Offer, including regular quarterly dividends, would have to be remitted to Sears Holdings by shareholders who tender. An e-mail sent April 26, 2006, to Mr. Crowley from Mr. William Phelan, VP & Controller of Sears Holdings stated as follows:

> "From my perspective, the key point is that the majority of the minority have already accepted the $18.00 offer and all shareholders can receive their $18.00 immediately (actually ten days after) when they tender. To pay a dividend would provide a mixed message to these shareholders, giving them a reason to hold the shares longer and delay the process. That would not be in the best interest of Sears Canada, its associates or the shareholders."

[280] Viewed in the context of events that were unfolding in relation to the Offer, the statements relating to the non-payment of dividends could be construed as threatening in nature and, together with other "warnings" relating to decreased liquidity and the increasingly competitive Canadian retail environment, intended to exert pressure on the minority shareholders to tender to the bid. Despite the business purpose advanced by Sears Holdings in explaining their decision to announce the cessation of dividend payments to Sears Canada shareholders, we do not regard it as co-incidental that this announcement was issued at a time when it appeared that minority shareholders were unwilling to tender at the then bid price.

(v) Sears Holdings' Dealings with the Special Committee of Sears Canada

[281] The Pershing Group raised several complaints relating to the manner in which Sears Holdings dealt with the Special Committee of Sears Canada. They submit that this conduct is remarkable and should be deeply troubling to the Commission. In evaluating the validity of these complaints, we had the benefit of the testimony of Mr. William Anderson, the Chair of the Special Committee. All of the parties, including Sears Holdings, acknowledged Mr. Anderson to be a very credible and impressive witness. We found Mr. Anderson to be a credible witness who gave his evidence in a straightforward, thoughtful and balanced fashion.

[282] It is important to set out the factual background to the complaints made in this regard. On February 21, 2006, Sears Canada mailed its Directors' Circular concerning the insider bid. The voting members of Sears Canada's board (i.e. the six independent directors comprising the Special Committee) recommended unanimously that the shareholders of Sears Canada reject the Offer of Sears Holdings and not tender their shares to the insider bid. The mere fact that Sears Holdings chose to pursue a bid which the Special Committee considered to be inadequate does not, in our view, constitute evidence of coercive conduct as suggested by the Pershing Group.

[283] In support of this recommendation to reject the Offer, the Special Committee noted, among other things, that:

(a) the Offer of Sears Holdings was financially inadequate;

(b) the consideration offered by Sears Holdings was significantly below the valuation range of Genuity;

(c) the consideration offered by Sears Holdings was at a significant discount to the average trading price of the shares of Sears Canada on the Toronto Stock Exchange over the period following the initial announcement of the Offer on December 5, 2005;

(d) the Offer was made at a time when the impact of the steps being taken by Sears Canada in the last half of 2005 to reduce costs and improve the company's financial results had not yet become evident; and

(e) the Offer did not reflect the benefits and savings that would be realized by Sears Holdings if its Offer was successful.

[284] In addition, the Special Committee also expressed their view that the Offer had been "opportunistically timed" and that it "exerts pressure" on Sears Canada and its minority shareholders as evidenced by a number of factors including Sears Holdings' application for exemptive relief to permit it to mail its Circular without including the required formal valuation as well as the absence of a minimum tender condition under the Offer.

[285] This set off a chain of events. On February 22, 2006, Sears Holdings issued a press release in response to the Directors' Circular. This press release quoted Alan Lacy, the Vice Chairman of Sears Holdings as follows:

> "We are disappointed that the Special Committee has recommended against our Offer; however we recognize that the Special Committee was constrained in its ability to recommend that shareholders accept our offer as a result of the valuation range contained in what we believe to be a flawed valuation report."

[286] Having in essence attacked the basis for the Special Committee's recommendation as being "flawed", Sears Holdings went on in their press release to set out a detailed chronology of the purchases and sales of Sears Canada shares by members of the Special Committee in the three years prior to the issuance of the Directors' Circular. They suggest in their press release that shareholders should consider whether these actions of the individual members of the Special Committee are "consistent with the Genuity valuation report, which is the principal underpinning of the Special Committee's recommendation." Mr. Anderson, in giving his evidence, made it clear that he felt that these comments were unfair and misleading in that they did not reflect the fact that some members of the Special Committee were precluded from buying Sears Canada shares as a result of trading restrictions during the relevant time period. We have concluded that the purpose of these statements in the Sears Holdings press release was to call into question the good faith and bona fides of the Special Committee members by underscoring the perceived inconsistency between their

recommendation with regard to the Offer and their own past trading practices with regard to the shares of Sears Canada.

[287] The Sears Holdings press release also attributed to members of the Special Committee concerns pertaining to the financial condition and stability and the ongoing business prospects of Sears Canada. Mr. Anderson's evidence before us was that these statements were taken out of context. We have concluded that Sears Holdings used these prior statements out of context and in a misleading fashion in an effort to pressure the shareholders of Sears Canada to tender to its bid.

[288] Mr. Anderson made it clear that despite numerous requests made to Sears Holdings for access to information which the Special Committee felt they needed in order to fulfill their statutory mandate, access to this information and documentation was either delayed or never provided at all. Into the latter category falls the Natcan lock-up agreement, the Vornado Agreement and the Support Agreements with BNS, Scotia Capital and RBC.

[289] In the cross-examination of Mr. Anderson, we learned that the draft Notice of Change to Directors' Circular originally described the insider bid of Sears Holdings as "coercive". The final version of the Notice of Change to Directors' Circular dated April 12, 2006, did not include that word. Mr. Anderson conceded that the Special Committee agreed to take that reference out of the final version of their Directors' Circular as a result of requests made by representatives of Sears Holdings. However, his evidence was that the Special Committee was not coerced into doing so.

[290] Subsequently, on February 27, 2006, Sears Canada issued a press release announcing that all six of the independent directors on its board did not intend to stand for re-election at the next annual meeting of shareholders in the spring, 2006. These six directors constituted the members of the Special Committee. At this time, Mr. Vaux of Scotia M & A sent an e-mail dated February 28, 2006, to Mr. Crowley and others in which he stated as follows:

> "If there was a time to issue a press release about Holdings intending to put forth its own slate of directors and to effect some changes, this is probably it. Just try to sound disappointed with their actions and again let's raise the inconsistencies about

how this obviously further distances them from their reject recommendation."

[291] The day after the announcement was made that the independent directors would not stand for re-election, Mr. Lacy, the representative of Sears Holdings on the Sears Canada board, approached the independent directors to ask them if they would resign immediately instead of waiting for the annual general meeting on May 9, 2006. The independent directors refused to do so because of the fiduciary obligations they owed to Sears Canada. That Sears Holdings would seek the early resignation of the members of the Special Committee in the midst of an insider bid in respect of which the Special Committee had expressed serious reservations is of significant concern to the panel. It is also noteworthy that someone at Sears Holdings apparently leaked to the media the message that the independent directors of Sears Canada were "running for the hills" which appeared in a subsequent news report.

[292] Following the increase of the Sears Holdings Offer to $18.00 a share in conjunction with the announcement of the Vornado Agreement and the Support Agreements, the Special Committee received an updated Valuation and Inadequacy Opinion from Genuity which re-affirmed Genuity's prior valuation range for the Sears Canada shares. The Special Committee issued a Notice of Change of Directors' Circular in response to the revised Offer in which they continued to express a number of reservations "with respect to, or arising in light of, the revised Offer" of Sears Holdings but unanimously determined not to make a recommendation concerning the revised Offer. In their Notice, the Special Committee stated as follows:

> "The Special Committee has not been provided with copies of the support agreements pursuant to which certain Minority Shareholders have agreed to vote their Common Shares in favour of a going private transaction or the names of such shareholders. <u>As a result, the Special Committee is unable to assess whether the Common Shares subject to such agreements may be voted as part of the minority with respect to a going private transaction involving Sears Canada.</u>" (emphasis added).

[293] We do not and cannot know what impact the provision of the requested information and documentation might have had on the Special Committee's consideration of the revised Offer or on their determination not to make any recommendation to the Sears Canada minority shareholders with respect thereto. The result of Sears Holdings' refusal to provide this information to the Special Committee on the basis, as counsel to Sears Holdings submitted to us, that they had no specific statutory obligation to do so, was that the minority shareholders of Sears Canada were effectively denied the opportunity to know what impact the information might have had on the Special Committee's consideration of the revised Offer and on their determination to proceed with a neutral recommendation.

[294] As the Commission emphasized in the context of the *Hollinger* decision, the role of the Special Committee in the context of an insider bid is a critical component of the protections afforded to minority shareholders pursuant to Rule 61-501 (*Re Hollinger Inc.* (2005), 28 O.S.C.B. 3309). It is understandable that all bidders, including insider bidders, will want to successfully complete their bid at the lowest price reasonably possible in the circumstances. In fact, it is to be expected that parties will act rationally and in their own economic interests. For this very reason, minority shareholders cannot be expected to look to the insider making the bid to protect their rights and interests. Rather, it is the statutorily mandated role of the Special Committee in such circumstances to safeguard the rights and interests of the public shareholders of the company during the course of an insider bid by, among other things, obtaining a formal valuation from an independent valuator of its choice and making an informed recommendation to the shareholders in relation to the insider bid.

[295] Insiders who wish to make an insider bid for a public company and take it private assume an obligation to co-operate with the Special Committee as it discharges its important and statutorily mandated function. We do not know to what extent Sears Holdings' actions and public attacks on the members of the Special Committee played a role in the individual decisions of the members not to seek re-election. We do know that, had the members of the Special Committee resigned immediately as Sears Holdings requested, that would have left no-one on the board of Sears Canada to protect the rights and interests of that company's minority shareholders during the pendency of the insider bid. We are of the view that the conduct of Sears Holdings as regards their dealings with

the Special Committee, formed in accordance with the requirements of Rule 61-501, fell far short of the conduct we would expect of even the most determined offeror in the pursuit of its insider bid.

(vi) Dissent Rights

[296] The February 22 press release of Sears Holdings quotes Mr. Lacy as saying: "On March 17, 2006, shareholders will have two choices: either tender to the Sears Holdings offer or continue to hold shares, which we believe will thereafter trade at a significant discount to our offer." Counsel for Sears Holdings, BNS and Scotia Capital and RBC all urged us to bear in mind that those shareholders who are unhappy with the Offer can exercise their dissent and appraisal rights under Canadian corporate law. We agree. It is noteworthy that this choice was not mentioned as an option for shareholders in the February 22 press release. We cannot do more than speculate as to whether this omission reflects Sears Holdings' view as expressed by Mr. Crowley in a February 24 e-mail to Mr. Lampert that "dissenters rights in Canada do not work well for the dissenter in practice. It can take years for the dissenter to get the money (10 years in one case). Not a practical solution for shareholders." It is worth noting that, by extending the expiry date of the Offer to August 31, 2006, and the closing date for the proposed SAT to mid-December 2006, in accordance with the terms of the Support Agreements, there is resulting delay to other Sears Canada shareholders who might wish to commence the dissent and appraisal process.

(vii) Exemption Application in Relation to the Valuation

[297] As noted earlier in these Reasons, Sears Holdings applied to the Commission and other securities regulators for relief from the requirement to include a formal valuation of the Sears Canada shares in its Take-Over Bid Circular on the basis that the Genuity Valuation was not being prepared quickly enough. The resolution of the exemption request is described earlier in these Reasons and need not be repeated here. While the Valuation was, of course, critical information for minority shareholders to have, Sears Holdings considered it appropriate to seek exemptive relief to

dispense with the need to include the Valuation in its Circular so that they could proceed with its mailing.

(viii) Threatening Legal Action Against Desjardins

[298] When Sears Holdings took note of Mr. Mayers comments in the press in which he was generally critical of the bid price under the Offer, Sears Holdings took steps to commence a libel action against Desjardins. Desjardins subsequently issued a public apology for the previous comments of Mr. Mayers, one of their executives. We are unable to conclude, based on the little we know about what precipitated these events, that this action on the part of Sears Holdings provides evidence of coercive conduct.

(ix) April 20 Complaint Against the Principal of Pershing

[299] On April 20, 2006, Sears Holdings filed a complaint with Commission Staff in relation to the conduct of the Pershing Group. This complaint had two components to it. The first of these components outlined allegations of breaches of the act against the Pershing Group which have been fully addressed earlier in these Reasons. The other component of the complaint related to the past conduct of Mr. Ackman. Sears Holdings included with their complaint a number of articles and U.S. court decisions concerning Gotham Partners L.P., a public and private equity partnership that Mr. Ackman had co-managed before he launched Pershing in January 2004. Mr. Ackman, through his counsel, took objection to what he characterized as a pre-emptive, personal attack based on his past business dealings which were unrelated to Pershing, Sears Holdings or Sears Canada. Mr. Ackman's response to the complaint made against him underscored the selective and misleading nature of the materials that were filed with Commission Staff. The Commission takes complaints which are filed with it seriously and we expect that all market participants, acting directly or through their counsel, will be duly diligent in ensuring that information filed in support of such complaints is balanced, accurate and not misleading.

(x) Other Complaints

[300] The Pershing Group made a number of other complaints in support of their claim that the Offer is coercive and abusive which relate to the fact that Sears Holdings entered into the Vornado Agreement and the Support Agreements, provided inadequate and deficient disclosure and generally took steps designed to coerce minority shareholders to tender into their insider bid. We need not address these complaints here as they are dealt with elsewhere in these Reasons.

(xi) What is the Appropriate Remedy?

[301] The Commission may make an order under subsection 127(1) of the Act that trading in any securities by or of a person or company cease permanently or for such period as may be specified (the cease trade order) where, in its opinion, it is in the public interest to do so.

[302] The Commission's public interest jurisdiction is derived from the broad mandate conferred upon it under the Act to provide protection to investors from unfair, improper, or fraudulent practices and to foster fair and efficient capital market and confidence in their integrity (section 1.1 of the Act).

[303] In *Re Cablecasting Ltd.*, (1978) O.S.C.B. 37, the Commission applied its public interest jurisdiction to a "going private transaction" effected in compliance with the requirements of the Ontario *Business Corporations Act*, R.S.O. 1990, c. B.16 but not in compliance with the disclosure requirements applicable to issuer bids under the predecessor policy to Rule 61-501. In its decision, the Commission balanced the need for intervention where a transaction was inconsistent with the best interests of investors against a preference for a policy oriented solution but, ultimately, did not have to issue a cease trade order because the respondent undertook to obtain minority approval. The Commission, however, provided guidance on when it was more likely to intervene under the rubric of its public interest jurisdiction despite the absence of any breach of Ontario securities law:

> "If the transaction under attack was of an entirely novel nature, Commission action

might seem more appropriate. Another relevant consideration in assessing whether to act against a particular transaction is whether the principle of the new policy ruling that would be required to deal with the transaction is foreshadowed by principles already enunciated in the Act, the regulations or prior policy statements. Where this is the case the Commission will be less reluctant to exercise its discretionary authority than it will be in cases that involve an entirely new principle." (*Re Cablecasting*, supra, at page 43).

[304] The frequently cited *Canadian Tire* decision established that the Commission can and will intervene on public interest grounds even if there is no breach of the Act, the regulations or Commission policies. In such circumstances, the Commission's public interest jurisdiction will be invoked where necessary to prevent an otherwise abusive transaction from occurring. Accordingly, the standard for intervention in such circumstances is more than a complaint of unfairness and will generally involve some showing of a broader impact on the operation of the capital markets (*Re Canadian Tire Corp.* (1987), 10 O.S.C.B. 858 at 948, affirmed (1987) 37 D.L.R (4^{th}) 94 (Div. Ct).

[305] In the *H.E.R.O. Industries* case, the Commission intervened in the public interest to stop a transaction where a market participant initiated a transaction that was purposefully designed to exploit a loophole in securities legislation. The Commission stated that:

"Finally, Middlefield's conduct seems to us to be clearly abusive of the integrity of the capital markets, which have every right to expect that market participants like Middlefield will adhere to both the letter and spirit of the rules that are intended to guarantee equal treatment of offerees in the course of a take-over bid…" (*Re H.E.R.O. Industries Ltd.* (1990), 13 O.S.C.B. 3775 at page 3795).

[306] The parties in this case, including Commission Staff, all agreed that in the absence of any contravention of Ontario securities law, a finding that the conduct of Sears Holdings in relation to their Offer was abusive of the capital markets would be required in order to warrant an order being made to cease trade the Offer under section 127 of the Act.

[307] In view of the fact that we have found that the Vornado Agreement and the Support Agreements were entered into in contravention of subsection 97(2) of the Act, it is unnecessary for us to make a finding that the conduct of Sears Holdings in connection with their insider bid or the bid itself was "abusive" in order to support the exercise of our public interest jurisdiction under section 127 of the Act.

[308] Although it is unnecessary for us to do so, we find that elements of the conduct of Sears Holdings in pursuing their Offer were coercive and abusive of the minority shareholders of Sears Canada and the capital markets generally. Our finding in this regard is based on the detailed analysis and assessment of the conduct of Sears Holdings considered in totality as described in detail above.

[309] Sears Holdings relied upon the Support Agreements as a means of obtaining assurance of the necessary shareholder approval of a SAT. The purpose and effect of the Support Agreements are well described in an e-mail dated April 6, 2006, from Mr. Rudka to Mr. Crowley and Mr. Lacy of Sears Holdings after Sears Holdings had issued its press release announcing the Support Agreements. The e-mail congratulates Sears Holdings on its success and states:

> "Today's announcement will surprise the market and, given our conversations with the analysts and institutional shareholders, it will catch most off-guard. In fact, the rather unique tactic of securing the support of the majority through the derivatives trades and support agreements will make this transaction one of the most intriguing Canadian M & A trades in a long time."

[310] Sears Holdings and their financial advisor were aware that the approach they had employed to ensure the success of their Offer was "unique." Despite the unique and novel nature of the approach, the principle of fair and equal treatment to all minority shareholders without preference to some shareholders over others is a well-enunciated principle in Ontario securities law in the bid context and we therefore have no hesitation in applying this principle to this transaction in accordance with the Commission's guidance in the *Cablecasting* decision cited above.

[311] In this case, had we found that subsection 97(2) had not, technically, been contravened and despite the absence of a finding of joint actor status, we would nonetheless have determined that an order under section 127 of the Act was warranted to ensure that the votes attached to the shares that are the subject of the Support Agreements as well as the votes attached to the shares acquired by Sears Holdings pursuant to the Vornado Agreement ought not to count in the majority of the minority vote required on the SAT.

[312] Such intervention would be justified in the public interest in the circumstances of this case and consistent with our mandate under the Act. The purpose and effect of the Support Agreements was to secure the votes of a select few shareholders – namely, BNS, Scotia Capital and RBC – in connection with the SAT in return for which a deal was negotiated with respect to the Offer that ensured that the interests of these parties was addressed through the terms of the Offer. While there is nothing wrong with BNS, Scotia Capital and RBC wanting to ensure that the Offer was structured in the most advantageous manner possible from their particular tax perspective, allowing their votes to count in the majority of the minority vote on the SAT in these circumstances would be to turn a blind eye to the overriding principle underlying Rule 61-501 that all shareholders be treated, and be seen to be treated, fairly and equally unless differential treatment is reasonably justified. In our view, the same rationale applies to the Vornado shares. As subsection 2.1(5) of the Companion Policy to Rule 61-501 provides, giving a security holder preferential treatment in order to obtain that holder's support of the transaction will not normally be considered justifiable.

[313] Although we find that certain aspects of Sears Holdings' conduct in connection with the Offer was unfair, coercive, and at times abusive, we are not of the view that the transaction as a whole is so abusive of the minority shareholders or the capital markets as to warrant an order cease trading the Offer entirely. Rather, we believe that a more proportionate and appropriate remedy is to order that Sears Holdings comply with all of its obligations under Ontario securities law in relation to its Offer and to cease trade the Offer subject to certain conditions. These conditions include a requirement that Sears Holdings amend its Take-Over Bid Circular in respect of the Offer and disclose that the votes attached to the shares of BNS, Scotia Capital and RBC as well as the Vornado shares previously tendered to Sears Holdings will be excluded for purposes of the required minority vote in connection with the SAT under Rule 61-501.

[314] The Pershing Group has requested that the Support Agreements be terminated as a term and condition of the cease trade order. Commission Staff urged us to carefully consider whether our jurisdiction to impose terms and conditions pursuant to section 127 extends so far as to permit us to effectively order that legal agreements between the bidder and third parties be terminated. Counsel for the Pershing Group maintains that they are not seeking an order that the Support Agreements be terminated. Rather, they are seeking an order that the bid be cease traded unless and until the Support Agreements are terminated. They argue that termination of the Support Agreements is therefore not a mandatory term of the order.

[315] The parameters of the Commission's jurisdiction to impose terms and conditions under a section 127 order was addressed by both the Ontario Court of Appeal and the Supreme Court of Canada in the *Asbestos* decision. The Supreme Court there stated as follows:

> "The breadth of the OSC'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 OSC has an unrestricted discretion to attach terms and conditions to any order made under s. 127(1)."
>
> (*Committee in the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission*, [2001] 2 S.C.R. 132 at page 149).

[316] The Court went on to say that the nature of any section 127 order and the terms and conditions that may attach to it must be consistent with the Commission's overall mandate under the Act.

[317] While we take significant comfort from the broad interpretation given to our section 127 authority by the Supreme Court of Canada, it is unnecessary in this case to test the precise limits of that jurisdiction. Counsel for the Pershing Group explained in their closing submissions the reason they are seeking the termination condition as follows: "If the order simply excludes from voting the shares of the banks, then one likely outcome is that we will then proceed to a subsequent acquisition transaction. The vote may well fail…Holdings is then perfectly at liberty to commence another offer, and our read of the support agreements is that they continue. There is no obvious termination

provision, based on our understanding of these agreements, and so the banks would continue to be bound to support that subsequent offer. We think that would have the effect of vitiating the order we have asked you to make today."

[318] It is a legitimate concern that the Order be cast broadly enough to ensure that the votes attached to the shares held by the parties to the Support Agreements, and to which the Support Agreements relate, are not included in calculating whether minority approval of any SAT has been achieved. As the Order refers to the Offer and any other offer made or to be made by Sears Holdings or any affiliate for the shares of Sears Canada, it appears to us broad enough to address this concern without including a condition that the Support Agreements be terminated. The issue of the continued effectiveness of the Support Agreements is not a matter that we need to address and is best left to the parties to deal with. Our Order makes it clear that Sears Holdings cannot include the votes attached to the shares of Scotia Capital, BNS or RBC to which the Support Agreements relate in the required minority approval under Rule 61-501 in the context of this Offer or any future offer which they may launch for the shares of Sears Canada. We believe that the desired result is achieved by cease trading the Offer or any future offer to be made by Sears Holdings for the shares of Sears Canada unless and until Sears Holdings abides by the condition set out immediately above and discloses the same in their Take-Over Bid Circular relating to this Offer or any future offer for the shares of Sears Canada.

DATED at Toronto this 8th day of August, 2006.

"Susan Wolburgh Jenah"
Susan Wolburgh Jenah

"Robert W. Davis"
Robert W. Davis

"Carol S. Perry"
Carol S. Perry