Recent Developments in the Regulation of Defensive Tactics in Canadian Take-over Bids

By Ethan Minsky

Canadian Securities regulators leave the decision to tender to a take-over bid to a target's shareholders. Once a bid is made, the target is 'in play' (for sale) unless and until the shareholders say it is not. Once the target is in play, management is encouraged to focus on obtaining the best sale terms and informing the shareholders, and discouraged from taking action that would prevent shareholders from having the choice. This can put management at odds with both bidders and shareholders, as management's fiduciary duties or its own self-interest, especially where there are multiple competing bids or where a bid is unsolicited or hostile, might lead it to conclude that the company should not be sold at all. The reasons vary - one bidder might want new management while another wants to keep current management, another bidder might be trying a low bid on for size, a corporate 'raider' might be looking to strip vital assets or take other action that management believes it has a duty to prevent. Whatever the reason, management often feels compelled to take defensive action.

Defensive actions fall into two broad categories- strategic efforts taken before any bid is made and tactical actions taken in the face of a specific bid. Strategic efforts, often referred to as "shark repellant", consist of charter and bylaw provisions adopted at a time when the company is not subject to a bid or other specific threat – these include the use of staggered boards, change of control and rights plans, super-majority voting, advance notice, limitations on the use of written consent resolutions and blank check preferred stock. Tactical defenses include rights plans, asset sales, white knights, recapitalizations or spin-off transactions and even the 'pac-man' defense (where the target offers to acquire the bidder). Most of these tactics are discouraged or even prohibited in Canada but rights plans, which can be used either strategically or tactically, have gained popularity in recent decades and are widely used.

A rights plan is a "poison pill" designed to discourage bidders by making the target less attractive or more expensive (through dilution of equity at low prices to existing shareholders, sale or distribution of assets at discounted prices, etc.). Rights plans can be strategic or tactical but, in Canada, they are allowed to remain in effect only for the limited purpose of buying time for the target to consider and respond to a specific bid or seek alternatives. As a general rule, regulators decide "when", not "whether", a rights plan must go. That said, although limited in scope, rights plans are one of, if not the most, effective tools in a target's war chest.

Canadian securities regulators exercise their public interest jurisdiction to limit defensive tactics with reference to National Policy 62-202, *Takeover Bids - Defensive Tactics* (**"NP 62-202"**), which sets the stage as follows:

> "[t]he primary objective of the take-over bid provisions of Canadian securities legislation is the protection of the bona fide interests of the shareholders of the target company. A secondary objective is to provide a regulatory framework within which take-over bids may proceed in an open and even-handed environment. The take-over bid provisions should favour neither the offeror nor the management of the target company, and should leave the shareholders of the target company free to make a fully informed decision. The Canadian securities regulatory authorities are concerned that certain defensive measures taken by management of a target

> company may have the effect of denying to shareholders the ability to make such a decision and of frustrating an open take-over bid process."

Recently, Canadian securities regulators acknowledged that the take-over bid environment might not be "open and even-handed". In 2013, the Canadian Securities Administrators (**"CSA"**) published proposed National Instrument 62-105, *Securities Holder Rights Plans* together with a proposed companion policy (collectively, the **"CSA Proposal"**) and the Autorité des marchés financiers (**"AMF"**), which also participated in publication of the CSA Proposal, concurrently published a Consultation Paper titled *An Alternative Approach to Securities Regulators' Intervention in Defensive Tactics* (the **"AMF Proposal"**). The CSA Proposal focused on rights plans, while the AMF Proposal focused on defensive tactics in general, including rights plans, the role of target boards and management's fiduciary duties, but both proposals recognized a need for change. However, after expiration of the comment periods, CSA and AMF decided not to proceed with either proposal. Instead, CSA announced that it intended to pursue a new harmonized proposal (the **"Proposed Amendment"**) based on amendments to the take-over bid regime. The Proposed Amendment was published for comment on March 31, 2015 and, although the comment period expired on June 29, 2015, it has not been adopted.

One of the concerns expressed in both the CSA Proposal and the AMF Proposal was that take-over bids can be coercive in that shareholders, who act individually, might feel pressure to tender to a bid they do not support rather than risk being left behind. The Proposed Amendment proposed to correct this by requiring that all non-exempt take-over bids:

(a) be subject to a mandatory condition that a minimum of more than 50% of all outstanding target securities owned by persons other than the bidder be tendered;

(b) be extended by the bidder for an additional 10 days after the bidder receives the mandatory minimum number of securities tendered and has announced its intent to take up tendered securities; and

(c) remain open for a minimum of 120 days, subject to limited exceptions.

It was in this context that the British Columbia Securities Commission (**"BCSC"**) decided in *Re Red Eagle*, 2015 BCSECCOM 401, and the Alberta Securities Commission (**"ASC"**) decided in *Re Suncor Energy Inc.* 2015 ABASC 984. These decisions confirm that the Proposed Amendment has not been adopted and both the CSA Proposal and the AMF Proposal rest in peace.

Red Eagle

CB Gold Inc. (**"CB"**), a Vancouver-based mineral resource exploration company, owned property in Colombia and was in need of capital. Red Eagle Mining Corporation (**"Red Eagle"**), another Vancouver-based mineral resource company with property in Colombia, proposed a friendly merger with CB during the first half of 2014 but no agreement was reached. On August 27, 2014 and January 28, 2015, respectively, the CB Board and shareholders adopted a rights plan.

In May, 2015, CB agreed to sell its Colombian property to OM.L Trading Inc. (**"OML"**), subject to shareholder approval. On June 16, 2015, Red Eagle announced that it would make a takeover bid for the shares of CB if the OML sale was not approved by the CB shareholders. By the proxy deadline for the CB shareholder meeting it was obvious that the CB shareholders had rejected the OML sale and Red Eagle's take-over bid formally commenced on June 29, 2015, subject to the condition that a minimum of 50% of

the CB shareholders tender to the bid (this condition was subsequently waived). On July 14, 2015, CB announced that the Red Eagle bid failed to provide adequate value for its shareholders.

On July 24, 2015, CB announced an agreement with Batero Gold Corp. (**"Batero"**) pursuant to which Batero would (i) invest $575,000 by way of a private placement (the **"Batero Placement"**) and (ii) make a bid for all of the CB shares. The Batero agreement, which was supported by management, included a "no shop" clause prohibiting CB from seeking alternative offers. CB completed the Batero Placement later that same day (July 24, 2015).

Red Eagle brought an application to cease trade (i) the CB rights plan (ii) the Batero Placement and (iii) the Batero bid.

Red Eagle claimed that the CB rights plan had served its purpose by giving CB the opportunity to generate an alternative proposal and that, especially in light of the "no shop" clause in the Batero agreement, the only purpose the CB rights plan served at the hearing date was to prevent shareholders from tendering to the Red Eagle bid. It also claimed that the Batero Placement was an inappropriate defensive tactic and that the Commission had the authority to force Batero and CB to unwind the Batero Placement and cease trade the Batero bid.

CB cited the Proposed Amendment and claimed that the Red Eagle offer was coercive because Red Eagle had waived the 50% minimum tender condition. CB also asserted that the Batero Placement was a legitimate private placement carried out for legitimate business purposes by a company in need of capital, that it had already spent a significant amount of the proceeds, and that it was not feasible to unwind the Batero Placement.

Batero asserted that the Batero Placement could not be unwound "from a legal or a practical perspective" and that the Batero Placement had not harmed the CB shareholders or the public markets.

BCSC staff submitted that BCSC should exercise its public interest jurisdiction to interfere with a private placement in the context of a take-over bid "… only where there is compelling evidence that a failure to intervene would be abusive of shareholders in particular and the capital markets in general" and that the Batero Placement did not present any such compelling evidence. Staff also expressed concern that BCSC might not have the authority to unwind the Batero Placement and suggested that a court might be a more appropriate forum in which to seek such a remedy.

BCSC agreed with Red Eagle and cease traded the CB rights plan. In doing so, it noted that the Proposed Amendment had not been adopted and acknowledged that there might be circumstances where a bid without a minimum tender condition is not coercive but stated that in the absence of such a condition it is critical that there be a secondary 10 day offering period. BCSC also reiterated the *status quo ante* - the question is "when", not "if", a rights plan must go and it listed the factors to be considered in making that decision. Because these factors are discussed at greater length by the ASC in the *Suncor* decision, I have deferred listing those factors to the *Suncor* discussion, below.

BCSC refused to cease trade the Batero Placement, noting that this request would scramble different legal and regulatory issues, including corporate law questions going to management's fiduciary duties and the 'business judgment rule', as well as securities regulatory issues including the question of permissible defensive tactics under NP 62-202. BCSC also expressed reluctance to engage in duplicative oversight, noting that TSX Venture had conditionally approved the Batero Placement and deferring to its mandate and expertise. Although BCSC acknowledged that it had jurisdiction to cease trade a private

placement, it held that a private placement should only be blocked by a securities regulator where there is clear abuse of the target shareholders and/or the capital markets and there was no evidence that the Batero Placement constituted any such abuse. Finally, BCSC acknowledged that it might not have the ability to unwind a completed private placement of an issuer in financial distress that has already spent the proceeds.

Suncor Facts

Suncor Energy Inc. (**"Suncor"**) and Canadian Oil Sands Limited (**"COS"**) are both reporting issuers headquartered in Calgary, Alberta. Suncor owns approximately 12% of the Syncrude Joint Venture in addition to other producing assets; COS owns approximately 37% of the Syncrude Joint Venture and has no other producing assets. The Syncrude Joint Venture operates the (large) Canadian oil sands project located in the Athabasca oil sands near Fort McMurray, Alberta. In the face of distressingly low oil prices, the Syncrude project faces economic challenges.

In April of 2013, the COS shareholders approved a rights plan (the **"Old Plan"**) that would have thwarted any takeover bid outstanding for less than 60 days. On October 5, 2013, Suncor launched a 60 day bid that qualified as a "permitted bid" under the Old Plan. On October 6, 2013, in response to the Suncor bid, the COS Board of Directors adopted a new rights plan (the **"New Plan"**) that provided that a bid was not a "permitted bid" unless it was to remain open for at least 120 days (as would have been required by the Proposed Amendment had the Proposed Amendment been adopted). After consulting with its advisors, the COS Board concluded, among other things, that the Suncor bid substantially undervalued COS and, in any event, COS did not need to be sold. It instructed management to look for alternatives and, on October 19, 2015, it recommended that the COS shareholders reject the Suncor bid.

Suncor asked the ASC to cease trade the New Plan, claiming that the Old Plan provided all of the protection necessary or desirable. COS argued that the New Plan was a reasonable and justifiable response to a financially inadequate and "opportunistic" Suncor bid.

In its analysis, the ASC referred to the CSA Proposal and the Proposed Amendment, noting that none of these had been adopted. The ASC then went on to list the following key factors to be considered in cease trading a rights plan derived from, among other prior decisions, in *Re Royal Host Real Estate Investment Trust and Canadian Hotel Income Properties Real Estate Investment Trust* (1999), 8 ASC 3672 #08/48:

- whether shareholder approval of the rights plan was obtained;
- when the plan was adopted;
- whether there is broad shareholder approval for the continued operation of the plan;
- the size and complexity of the target company;
- the other defensive tactics, if any, implemented by the target company;
- the number of potential, viable offerors;
- the steps taken by the target company to find an alternative bid or transaction that would be better for the shareholders;
- the likelihood that, if given further time, the target company will be able to find a better bid or transaction;
- the nature of the bid, including whether it is coercive or unfair to the shareholders of the target company;
- the length of time since the bid was announced and made;

- the likelihood that the bid will not be extended if the rights plan is not terminated.

Applying the *Royal Host* factors to the Suncor bid, ASC cease traded the New Plan, but only after the expiration of a one-month grace period intended to give COS more time to pursue alternatives and respond to the Suncor bid.

Both Suncor and Red Eagle are careful and comprehensive decisions and each covers more ground than I have covered in this article. I have limited my discussion of them to the purpose at hand, which is to show that the regulation of defensive tactics in take-over bids in Canada remains largely unaffected by the CSA and AMF Proposals and the Proposed Amendment which, as stated above, has yet to be adopted.

Postscript:

On February 26, 2016, after this article was originally published, the CSA issued a Notice of Amendments to the Take-Over Bid Regime (the **"Notice"**) in which it announced that, effective May 9, 2016 (or perhaps later in Ontario), it was adopting, with modifications, the changes described in the Proposed Amendment. The Proposed Amendment, which was discussed earlier in this article, was originally published for comment on March 31, 2015, with a comment period that expired June 29, 2015. The only significant departure from the regime originally suggested in the Proposed Amendment was to reduce the mandatory minimum deposit period for all non-exempt take-over bids from 120 days (the period suggested in the Proposed Amendment) to 105 days.

The new regime proposes to address the concern, expressed in both the CSA Proposal and the AMF Proposal, that take-over bids can be coercive in that shareholders, who act individually, might feel pressure to tender to a bid they do not support rather than risk being left behind. The Notice proposes to address this concern by requiring that all non-exempt take-over bids:

(a) be subject to a mandatory condition that a minimum of more than 50% of all outstanding target securities owned by persons other than the bidder be tendered;

(b) be extended by the bidder for an additional 10 days after the bidder receives the mandatory minimum number of securities tendered and has announced its intent to take up tendered securities; and

(c) remain open for a minimum deposit period of 105 days, subject to two exceptions – if either exception applies the bid must remain open for a minimum of 35 days.

The Notice cautions readers that the CSA has determined that it will not amend National Policy 62-202, Defensive Tactics, in connection with these amendments to the Take-Over Bid regime, and that National Policy 62-202 continues in effect.

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