# Canadian Securities Regulators Chart New Course for Regulation of Hostile Take-over Bids

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On March 31, 2015, Canadian securities regulators published proposed changes to Canada's harmonized take-over bid rules that will significantly alter the way in which unsolicited or hostile take-over bids are carried out. The changes, aimed at "rebalancing" the current dynamic between hostile bidders and target boards, will provide target boards with considerably more time to respond to hostile bids. The changes will also impose new requirements on take-over bids which will significantly lessen a hostile bidder's leverage.

## CURRENT PRINCIPLES OF HOSTILE BID REGULATION IN CANADA

Canada has long been a comparatively open and unrestrictive environment for hostile take-over activity. This is principally attributable to the approach of Canadian securities regulators to the regulation of hostile take-over bids which has hewed closely to the following principles:

- Shareholders should be left free to decide whether to tender to a bid, whether or not it is acceptable to the target board.

- Securities regulators will intervene where directors of a target company take actions that have the effect of preventing shareholders from accepting a take-over bid.

- Directors may use defensive tactics such as shareholder rights plans or "poison pills" in order to find superior alternatives to a hostile bid. But eventually, typically 45–70 days after a hostile bid is commenced, "there comes a time for the pill to go".

- Securities commissions will intervene to take down or cease trade "chewable" pills, (*i.e.*, rights plans that permit take-over bids as long as they are (i) open for 60 days, (ii) conditional on the tendering of at least 50 per cent of shares not owned by the bidder, and (iii) required to be extended by 10 days), even when they have been approved by shareholders.

- Partial bids (*i.e.*, bids for less than all of the outstanding shares) and bids with no (or a waivable) minimum tender condition are not coercive in the view of Canadian securities regulators, despite the repeated protestations of target boards to the contrary.[1]

In recent years, there have been hostile bids on the margin that have challenged or suggested a wavering from some of these broad principles. Some securities commissions have shown a new willingness to allow a rights plan to remain in place where there is broad support for the rights plan from shareholders. However, other securities commissions have continued to uphold the individual right of a shareholder to tender to an offer regardless of the majority sentiment of shareholders.[2] These conflicting approaches to rights plans led the Canadian Securities Administrators (CSA), a body that comprises all 13 of Canada's provincial and territorial securities regulators, to re-examine the Canadian approach to the regulation of hostile bids and the use of defensive tactics. The result is the proposal to make a number of significant changes to Canadian take-over bid rules that reflect a departure from the foregoing principles in key respects.

## THE CSA'S PROPOSED AMENDMENTS TO THE TAKE-OVER BID RULES

On March 31, 2015, the CSA published, for a 90-day comment period, proposed amendments to the take-over bid rules (Proposed Bid Amendments). The Proposed Bid Amendments will require that all formal take-over bids have the following features:[3]

- Mandatory Minimum Tender Requirement: The bid must be subject to a mandatory tender requirement that a minimum of more than 50 per cent of all outstanding target securities owned or held by persons other than the bidder and its joint actors be tendered before the bidder can take up any securities under such bid. This contrasts with the current take-over bid rules that do not impose any minimum tender condition.

- 10-Day Extension Requirement: The bidder must extend the bid for an additional 10 days after it achieves the mandatory minimum tender requirement and announces its intention to take up and pay for the securities deposited under the bid. Current take-over bid rules permit, but do not require, a bidder to extend (unless there is an amendment to the bid).

- 120-Day Requirement: The bid must remain open for a minimum of 120 days, subject to the ability of the target board to waive, in a non-discriminatory manner when there are multiple bids, the minimum period to a period of no less than 35 days. The 120-day requirement may be waived if (i) the target board states in a news release a shorter deposit period for the bid, or (ii) the target issues a news release stating that it has agreed to enter into, or determined to effect, a specified alternative transaction. The current take-over bid rules require that a bid be open for at least 35 days.

## A PATH FORWARD HAS BEEN CHOSEN

The CSA's Proposed Bid Amendments promise a harmonized path forward for Canadian take-over bid regulation after competing proposals were made by the CSA and by Quebec's Authorité des marchés financiers (AMF).

### The CSA's 2013 Proposal

In March 2013, the CSA had proposed for comment changes to the regulation of shareholders rights plans.[4] The CSA reform proposals sought to address concerns that the current approach of Canadian securities regulators to rights plans was too favourable to hostile bidders, leaving target boards with little leverage to negotiate with a hostile bidder and not enough time to generate alternatives for target shareholders. Another concern that the CSA sought to address was that the policy of securities regulators to cease trade rights plans subjects target shareholders to pressure to tender, even if they are not generally supportive of the bid on its merits, out of fear of being left behind in an illiquid stock if the bidder were to acquire less than all of the outstanding shares of the target company.

To address these concerns, the CSA had proposed in March 2013 a new approach to rights plans that would have allowed companies to maintain a rights plan in place without intervention by Canadian securities regulators so long as the rights plan had been approved at the last shareholders' meeting or had been approved by shareholders within 90 days if adopted in the face of a bid. The proposed changes would have in effect afforded companies at least 90 days to respond to a bid, compared to the 45 to 70 days that target boards have historically been afforded. The proposal also contemplated that companies could maintain a shareholder-approved shareholder rights plan defence indefinitely, subject to continuing shareholder support.

### The AMF's 2013 Proposal

At the same time that the CSA (including the AMF) released its 2013 proposal on shareholder rights plans, the AMF released a parallel discussion paper that proposed a more fundamental change to the regulation of defensive tactics.[5] The AMF proposed that Canadian securities regulators replace the existing policy on defensive tactics (National Policy 62-202[6]) in favour of a much more deferential approach that would respect the decisions of target boards, recognizing the fiduciary duty of directors to act in the best interests of the corporation. Under the AMF's proposal, securities regulators would limit their intervention in the operation of defensive tactics unless the target board had inadequately managed its conflicts of interest or those of management or the tactics were abusive of shareholder rights.

The AMF proposal advocated a more fundamental departure from current Canadian regulation of defensive tactics whereby shareholders would be the ultimate deciders of whether they would accept an unsolicited offer. The AMF proposal, if followed, would have resulted in a director-centric approach, similar to the approach under Delaware law, whereby the directors, and not the shareholders, would hold the authority to determine whether there should be a change of control.

### The United CSA Proposal

The proposed amendments published by the CSA in March are the culmination of 24 months of consultation by the CSA following the publications by the CSA and the AMF of their 2013 proposals. The CSA and the AMF have determined not to proceed with their respective earlier proposals and instead are proceeding with the Proposed Bid Amendments. The CSA also stated that it is not currently contemplating any changes to its existing defensive tactics policy.

According to the CSA, the Proposed Bid Amendments intend to "enhance the quality and integrity of the take-over bid regime and rebalance the current dynamics among offerors, offeree issuer boards of directors, and offeree security holders by (i) facilitating the ability of offeree issuer security holders to make voluntary, informed and co-ordinated tender decisions, and (ii) providing the offeree board with additional time and discretion when responding to a take-over bid."[7]

The Proposed Bid Amendments would leave intact the overarching principle of Canadian take-over bid regulation that it is the shareholders, not the directors, who should decide whether a change of control should occur. While the bid amendments will give boards more time and greater leverage in dealing with hostile bidders, shareholders would continue to have the ultimate authority to determine whether a bid should be accepted. The CSA has not proposed any changes to its defensive tactics policy. Thus securities regulators would continue to intervene where boards take steps that deprive shareholders of the ability to tender to a bid that otherwise satisfies the new legal requirements.

Although the CSA appears to be maintaining certain central policies, the proposed rule changes represent a reversal of several principles that have been applied by Canadian securities regulators for many years. In effect, the Proposed Bid Amendments mark the following evolution in CSA's thinking on hostile bids:

- Despite almost three decades of cease trading rights plans after 45–70 days following commencement of a hostile bid, the CSA has come around to agree with target directors and many of their advisors that this approach does not in many cases provide a sufficient period of time to conduct a proper auction for a company or generate other superior alternatives for shareholders.

- Notwithstanding the conclusion of a number of securities regulatory panels that partial bids and bids with waivable (or no) minimum tender conditions are not coercive to shareholders, the CSA is now proposing to impose an irrevocable minimum tender requirement for all bids that will render partial bids extremely difficult to accomplish.

In these respects, the Proposed Bid Amendments represent an abrupt about face when it comes to so-called chewable pills that have "permitted bid" exceptions. Because the TSX requires that rights plans be approved by shareholders within six months of adoption, the vast majority of rights plans adopted by Canadian companies have permitted bid exceptions that are essential in order to win the voting recommendations of proxy advisory firms such as Institutional Shareholder Services. The main elements of a permitted bid are (i) a minimum 60-day bid period, (ii) an irrevocable majority minimum tender condition, and (iii) a mandatory 10-day extension. With the Proposed Bid Amendments all take-over bids will need to have these elements of a permitted bid.

## RAMIFICATIONS OF A LONGER BID PERIOD

Many of the ramifications of requiring a longer bid period for hostile bids are obvious and include the following:

- Target boards will have more time to respond to a hostile bid and to seek alternative transactions.

- With a hostile bidder facing the prospect of a four-month wait before its bid can be accepted, the target board will have much greater leverage to negotiate with the hostile bidder, particularly since the target board can reduce the 120-day period to as little as 35 days (the current minimum bid period).

- Speed of execution will cease to be one of the advantages of bypassing the board and going straight to shareholders with an unsolicited bid.

- The automatic availability of a longer bid period to target boards should reduce the need for securities commission intervention in bids.

- Acquirers weighing the costs of waging a hostile take-over battle will have to budget more time and risk greater probability that competing bids or white knights will emerge before their bid expires.

- Bidders that require financing will need to maintain financing arrangements for a much longer period of time following commencement of the bid.

The CSA's proposals to lengthen the minimum bid period by almost fourfold and the requirement of a mandatory 10-day extension have knock-on effects on other elements of the take-over bid rules. As a result of the Proposed Bid Amendments, the CSA has also proposed changes to the following:[8]

- Ability to Shorten Bid Duration: Bidders will be permitted to reduce the duration of their bid when the target board waives the 120-day minimum or accepts a rival offer resulting in an automatic reduction of the minimum deposit period to 35 days. However, the initial deposit period of a bid must not expire before 10 days after a bidder is required to send a notice of change. Thus, where a bid deposit period is shortened, shareholders will have at least 10 days to decide whether or not to tender to the bid.

- Take Up and Payment: The bidder will be prohibited from taking up securities under its bid until the conditions of the bid are satisfied and upon satisfaction of the conditions, the bidder must immediately take up securities deposited under the bid.

- Withdrawal Rights for Partial Bids: Under a partial bid, the withdrawal rights of security holders in respect of those securities that have been deposited during the initial deposit period will be suspended during the 10-day extension to allow for pro-ration of all securities deposited, including those deposited during the extension.

## A LOSS OF LEVERAGE FOR HOSTILE BIDDERS

While the significance of the lengthening of the bid period to 120 days is clear, the two other proposed bid amendments will markedly reduce the leverage that hostile bidders currently wield.

Much of the leverage that a hostile bidder has historically had has been the ability to waive the minimum tender requirement. Where a bidder can waive a minimum tender requirement, the bidder can acquire whatever is tendered, potentially acquiring negative control or a blocking position, if not majority control of the company. Because such a result may be feared by shareholders and factored into their decision of whether or not to tender, target boards routinely label bids that have no minimum tender condition or that reserve the bidder's right to waive the condition as "coercive".

A 50 per cent minimum tender requirement substantially raises the bar for a hostile bid to be successful. Shareholders will be protected from a bidder obtaining a negative control position without obtaining the support of a majority of the other shareholders.

The requirement that a successful bid be extended for at least 10 days provides a further protection to shareholders that reduces any urgency to tender to a bid. If a shareholder is doubtful about the bid, it can wait on the sidelines, see if a majority of shareholders support the bid, and then still have its shares taken up 10 days later. In this way, the 10-day extension requirement will make it more likely that fewer shareholders will feel the need to tender prior to the initial expiry of the bid.

## PARTIAL BIDS WILL BECOME RARE AND "ANY AND ALL" BIDS WILL NOT BE POSSIBLE

The 50 per cent mandatory minimum tender requirement will also effectively lead to the extinction of "any-or-all" bids and most partial bids.

Partial bids, whereby a bidder seeks to acquire less than all of the outstanding shares, might still technically be permitted under the new rules, but would become extremely difficult to carry out. Bidders who seek to bid for just 30 per cent or even 50 per cent ownership of a company, rather than acquiring 100 per cent, will rarely see an enthusiastic response from target shareholders, who will be reluctant to tender, both because of the lower profit that can be realized in the sale and because the shares that they are unable to sell will be in a company that now has a dominant shareholder. Consequently, it is unusual for a bidder to be able to convince at least 50 per cent of shareholders to tender into a partial bid.

"Any and all" bids are bids whereby the bidder bids for all shares, but does not set a minimum tender requirement. With the new minimum tender requirement of at least 50 per cent of the shares not owned by the bidder, such a bid would not be possible. Instead, a bidder would either have to make a partial bid or bid for all of the shares and acquire at least half of the shares bid for, and likely more after the bidder is required to extend for an additional 10 days.

The hostile bid of Pala Investments in 2009 for NEO Materials and Carl Icahn's hostile bid in 2010 for Lions Gate Entertainment are two prominent examples of bids that would not be feasible under the proposed new rules.

### Pala Investments Bid for Neo Materials

In 2009, Pala Investments, a 20.5 per cent shareholder of Neo Material Technologies Inc., made a partial bid for just 9.5 per cent of Neo's shares. The success of Pala's bid was conditional on Neo's waiving its rights plan to allow the Pala bid to proceed notwithstanding the absence of a 50 per cent minimum tender requirement. Instead of waiving its rights plan, Neo adopted a stricter rights plan that prohibited partial bids altogether. Neo promptly submitted the new rights plan to shareholders for approval and obtained overwhelming support.

As expected, Pala applied to the Ontario Securities Commission (OSC) to cease trade the Neo rights plan. Considering the circumstances and the overwhelming support for the plan, the OSC declined to cease trade the rights plan.[9]

Had the Proposed Bid Amendments applied to the Pala bid, it is highly unlikely that a shareholders rights plan would have been required to prevent Pala's bid. Given the level of support of Neo shareholders for the rights plan in the face of Pala's bid, it is clear that an overwhelming majority of shareholders would not have tendered to Pala's bid. Consequently, even in the absence of a rights plan prohibiting partial bids, Pala would not have been able to clear the 50 per cent minimum tender requirement in order to proceed.

### Carl Icahn's Bid for Lions Gate Entertainment

Similarly, the hostile bid of Carl Icahn for Lions Gate Entertainment in 2010, in which Carl Icahn was able to increase his ownership of Lions Gate from 18.6 per cent to 38 per cent, would not have been possible had Icahn been required to condition his bid on a majority of the shares he did not already own being tendered to his bid.

Icahn had originally made a partial bid for Lions Gate seeking total ownership of only 29.9 per cent of Lions Gate shares. Icahn subsequently varied his bid to include a waivable condition that a minimum number of shares (enough to bring his ownership to 50.1 per cent) be tendered to the bid. Initially, Icahn's bid was blocked by Lions Gate's rights plan which contained the usual permitted bid requirements that at least a majority of the shares not held by Icahn or his joint actors be tendered. Lions Gate had sought to keep the rights plan in place with the approval of its shareholders. However, just one week prior to a meeting of Lions Gate shareholders to vote on the rights plan, the British Columbia Securities Commission (BCSC) cease traded the rights plan.[10] In explaining why the result of the vote would not have been relevant, the majority of the panel cited the fundamental right of each shareholder to decide whether to tender to a bid. In its decision, the BCSC was critical of the OSC's decision in Neo Materials as Neo's rights plan had deprived one-third of Neo Material's shareholders (those who had not supported the rights plan) of the opportunity to tender to Pala's bid.

Following the cease trading of Lions Gate's rights plan, Carl Icahn amended his bid to waive his 50.1 per cent minimum tender condition to make it an "any and all" bid, subsequently acquiring 13.2 per cent of Lions Gate's shares on his first take-up under the bid, bringing his total ownership to 31.8 per cent (which he subsequently increased to 38 per cent). Under the Proposed Bid Amendments, Icahn would have required triple the number of shares tendered to his bid (40.7 per cent of the outstanding shares) in order to be successful.

The changes now proposed by the CSA (including the BCSC) effectively reject the principle enunciated by the BCSC in its Lions Gate decision that the right to tender to an offer is an individual shareholder right. Instead, the Proposed Bid Amendments would continue to give shareholders the right to decide the outcome of a bid, but on a collective basis, not by vote, but by prohibiting a bid from proceeding unless a majority of shareholders tender to the bid.

## WHITHER RIGHTS PLANS?

While the Proposed Bid Amendments will give target boards more time to seek alternatives to a hostile bid and will require all bids to

in effect have common permitted bids features (without the target company having to adopt a rights plan), rights plans will continue to be relevant, though for more limited purposes. In particular, rights plans will continue to be relevant to regulate the ability of shareholders to accumulate large positions in a company through transactions that are exempt from the take-over bid rules. The CSA's Proposed Bid Amendments do not propose changing the exemptions to the take-over bid rules as had been recommended by some commenters on the 2013 proposal. As a result, shareholders will continue to have the ability to increase their ownership above the statutory 20 per cent threshold by acquiring shares through limited private transactions without triggering the formal take-over bid rules. The adoption of a rights plan would continue to be an effective defence against a shareholder increasing its ownership in a company through such exempt acquisitions.

It will be interesting to see whether rights plans could be used to afford a target board additional time after the new 120-day bid period has elapsed or to hold off a bidder indefinitely. But given the much greater hurdles that a bidder would have to cross under the Proposed Bid Amendments, presumably there will be a heavy burden on issuers to demonstrate that it is not "time for a rights plan to go" if a bidder has complied with the new rules.

## CONCLUDING THOUGHTS

The CSA's Proposed Bid Amendments promise to be the most significant changes to Canadian take-over bid regulation since securities regulators began intervening in the use of defensive tactics three decades ago. The CSA is not proposing to abandon the fundamental principle that it is shareholders and not the directors who should decide whether to accept an offer for control of the company. However, the CSA's objective of rebalancing the dynamics between hostile bidders and target boards will give substantially more time and leverage to target boards, while at the same time making the hurdles that bidders must overcome for a bid to be successful much higher and harder to meet. While hostile bids will continue to be feasible in the Canadian marketplace, acquirers considering their strategic options and being mindful of the new challenges these changes will bring will undoubtedly give greater consideration to exploring opportunities for friendly transactions. ■

1. See *Re Icahn Partners LP*, 2010 LNBCSC 398 [Icahn Partners]; *Re Neo Material Technologies Inc.*, 2009 LNONOSC 638 [*Neo Material*]; *Re Chapters Inc.*, 2001 LNONOSC 112; *Re Consolidated Properties*, 2000 LNONOSC 780.
2. In particular, the Alberta Securities Commission's decision not to take down (or "cease trade") the shareholders rights plans maintained by Pulse Data and the Ontario Securities Commission's decision to allow the rights plan of Neo Materials to continue in the face of a partial bid by Pala Investments have raised questions about what circumstances a rights plan could be left in place where there was significant level of shareholder support in the face of the bid.
3. *CSA Notice and Request for Comment – Proposed Amendments to National Instrument 62-104 Take-Over Bids and Issuer Bids, Proposed Changes to National Policy 62-203 Take-Over Bids and Issuer Bids and Proposed Consequential Amendments, OSC CSA Notice*, (2015) 38 OSCB 3021 (April 2, 2015).
4. *Proposed NI 62-105 Security Holder Rights Plans, Proposed Companion Policy 62-105CP, and Proposed Consequential Amendments*, OSC CSA Notice, (2013) 36 OSCB 2643 (14 March 2013).
5. *An Alternative Approach to Securities Regulators' Intervention in Defensive Tactics*, AMF Consultation Paper (14 March 2013).
6. *Take-Over Bids – Defensive Tactics*, OSC NP 62-202, (1997) 20 OSCB 3525 (4 July 1997).
7. *Supra* note 2 at 3022.
8. *Supra* note 2 at 3030.
9. *Neo Material*, *supra* note 1.
10. *Icahn Partners*, *supra* note 1.