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Weed Wars: Securities Commissions Weigh In on Aurora/ CanniMed Hostile Bid

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After a joint hearing in mid-December, the Ontario and Saskatchewan securities commissions released identical orders in respect of the unsolicited take-over bid by Aurora Cannabis Inc. for the issued and outstanding common shares of CanniMed Therapeutics Inc. and CanniMed's use of a shareholder rights plan in response to Aurora's unsolicited offer. Although the reasons of the securities commissions have not yet been released, several important implications have emerged from the orders regarding the use of shareholder rights plans as a deal protection measure.

Background

On November 14, 2017, Aurora disclosed that it had submitted an acquisition proposal to the board of directors of CanniMed to acquire CanniMed in consideration for Aurora shares. In its disclosure, Aurora added that it had entered into irrevocable lock-up agreements with shareholders representing 38% of the issued and outstanding CanniMed shares (collectively, the Locked-Up Shareholders). Under the terms of the lock-up agreements, the Locked-Up Shareholders are required to tender their CanniMed shares into Aurora's offer and "vote against other acquisition proposals or actions which might prevent, delay or frustrate Aurora's proposal." Notably, these lock-up agreements do not include termination provisions that would allow the Locked-Up Shareholders to terminate the lock-up agreements in the event that a third party made a superior offer to acquire CanniMed.

Three days later, CanniMed announced that it had entered into an arrangement agreement with Newstrike Resources Ltd. pursuant to which it would acquire all of the issued and outstanding common shares of Newstrike in consideration for CanniMed shares. When Aurora formally launched its unsolicited offer on November 24, 2017, it was made conditional on the non-completion of the Newstrike acquisition.

On November 29, 2017, CanniMed announced that it had adopted a poison pill. The press release stated that the poison pill "prevents Aurora from acquiring any CanniMed shares other than those tendered to its Hostile Bid or from entering into a new lock-up agreement in respect of its Hostile Bid other than those it has already entered into." As to the purpose of the poison pill, the press release indicated that it was to protect CanniMed shareholders from being coerced into tendering to Aurora's bid and to allow for the possibility of another acquisition transaction for CanniMed. Moreover, the press release suggested that the primary purpose of the poison pill was to protect the Newstrike transaction and was "not intended to deter the Hostile Bid or any other bid."

Submissions of the Parties

Aurora

In its application to the securities commissions, Aurora sought an order to cease-trade the poison pill, which it argued was tactically designed to deter its unsolicited offer and contained certain unusual provisions aimed at restricting CanniMed shareholders from exercising their right to respond to Aurora's offer. In particular, Aurora argued that the terms of the poison pill were inconsistent with National Instrument 62-104 – *Take-Over Bids and Issuer Bids* (NI 62-104), in several respects. For example, the definition of "Permitted Bid" in the pill did not allow for the reduction of the 105-day minimum deposit period in the event of an "alternative transaction," and the definition required an extension of 10 business days, rather than the statutory 10 calendar days, upon the satisfaction of all bid conditions. In addition, Aurora argued that the pill prevented additional CanniMed shareholders from entering into lock-up agreements with Aurora, whether hard or soft. The definition of beneficial ownership in the poison pill provided that a "Person will be deemed to be the Beneficial

Owner of...any securities which are subject to an agreement (including without limitation a Permitted Lock-Up Agreement) to tender or deposit them into any Take-over Bid made by such Person." As a result, Aurora was deemed to own the CanniMed shares held by the Locked-Up Shareholders for purposes of the pill and would be deemed to own any additional shares it might lock up whether by way of hard or soft lock-up.

Aurora also requested relief from the requirement in NI 62-104 that its bid remain open for a minimum of 105 days. In Aurora's view, CanniMed's proposed acquisition of Newstrike "in spirit" constituted an "alternative transaction." Although Aurora acknowledged that the Newstrike transaction did not meet the technical definition of "alternative transaction" in NI 62-104, which would automatically reduce the minimum deposit period for Aurora's offer to 35 days, Aurora made the policy argument that CanniMed did not require the 105-day minimum bid period to consider its bid and seek alternative transactions because it had already proposed the Newstrike acquisition. Aurora also argued that CanniMed shareholders should have the right to make a clear choice between two concurrent transactions. In Aurora's view, the 105-day minimum bid period for its offer would result in the "unequal treatment of offerors" in competing transactions, since CanniMed shareholders were scheduled to vote on the Newstrike acquisition on January 23, 2018, while the minimum bid period for Aurora's bid would expire over six weeks later.

CanniMed

CanniMed sought an order disentitling Aurora from relying on an exemption in NI 62-104 that would allow Aurora to purchase up to 5% of CanniMed's shares in the market. In CanniMed's view, should Aurora be permitted to purchase additional CanniMed shares, it would be in a de facto "blocking position" with respect to any alternative transaction, including the Newstrike acquisition, given the lock-up of 38% of the shares on terms that require holders to vote against any proposal that might frustrate Aurora's bid.

CanniMed Special Committee

The special committee of the CanniMed board sought an order from the securities commissions deeming Aurora and the Locked-Up Shareholders to be "joint actors" for the purpose of Multilateral Instrument 61-101 – *Protection of Minority Shareholders in Special Transactions* (MI 61-101). Such a determination would require Aurora to comply with the "insider bid" provisions of MI 61-101 and would significantly delay Aurora's offer. In support of its position, the CanniMed special committee argued that it was the Locked-Up Shareholders who approached Aurora to solicit a bid for CanniMed, usurping the function of the board, and that, notably, two directors of the CanniMed board were also directors and/or officers of three Locked-Up Shareholders at the relevant time. According to the CanniMed special committee's submissions, the Locked-Up Shareholders used confidential information obtained from directors of CanniMed to structure Aurora's bid and attempt to frustrate the acquisition of Newstrike. In addition, according to the CanniMed special committee, Newstrike's former financial adviser used confidential information it had obtained while it was engaged by Newstrike before it ceased its engagement in order to advise Aurora with respect to its offer.

The Orders

By orders dated December 22, 2017, the Ontario and Saskatchewan securities commissions cease-traded the poison pill and ordered Aurora to amend its bid circular to disclose any information that was obtained by Aurora from any person who was, at the relevant time, in a "special relationship" with CanniMed for the purpose of insider trading rules, or that was material to Aurora in structuring, or determining the timing of delivering, its proposal or implementing its bid.

However, the securities commissions denied the exemptive relief sought in Aurora's application relating to the characterization of the Newstrike acquisition as an alternative transaction, which would have reduced the 105-day minimum bid period to 35 days and allowed CanniMed shareholders to consider the Newstrike transaction and the unsolicited bid concurrently.

In addition, the securities commissions denied all of the relief sought by CanniMed and the CanniMed special committee, declining to restrict Aurora from purchasing additional shares in the open market or to characterize Aurora and the Locked-Up Shareholders as joint actors.

Implications of the Order

The facts and orders here give rise to numerous interesting and novel issues and will give the commissions the opportunity to provide guidance on a host of topics, from poison pills to deal protections. While we await the written reasons, two takeaways seem clear:

- When securities regulators adopted amendments to Canada's take-over bid regime in 2016, it was expected that the tactical use of shareholder rights plans to interfere with the normal operation of the take-over bid rules would be met with swift intervention by securities regulators.[1] The orders are consistent with this expectation. In a circumstance in which the poison pill was not designed to delay the take-up by Aurora of CanniMed shares tendered into Aurora's offer, but arguably to protect an existing transaction by seeking to limit Aurora's ability to consolidate a blocking position, the securities commissions nonetheless intervened.
- By denying all the other relief sought by Aurora, CanniMed and the CanniMed special committee, the securities commissions have signalled an intention to strictly adhere to the rules set out in the existing take-over bid regime. Part of the rationale motivating the amendments to the take-over bid regime in 2016 was to introduce greater certainty in the treatment of take-over bids and to reduce the inconsistencies caused by unique poison pill hearings in respect of unsolicited take-over bids. The orders indicate that the securities commissions are keen to preserve the uniform and predictable treatment of take-over bids, and that they will be reluctant to vary the rules in the heat of battle.

What to Watch For

We will provide additional commentary when the written reasons are released. When they are, we will be keeping an eye out for the following:

- There is limited case law (from both the courts and securities regulators) assessing the appropriateness of deal protections generally. Delaware courts have historically been suspicious of excessively strong deal protections, especially when they operate to make a transaction a *fait accompli* prior to a shareholder vote. We will be interested to see whether the securities commissions take this opportunity to comment on deal protections negotiated in transaction documents and the use of hard lock-up agreements.
- We will also be interested to see whether the securities commissions comment on the ability of a target company to pursue an acquisition transaction in the context of defending against an unsolicited take-over bid. This form of take-over defence is unusual in Canada, and it is an open question whether securities regulators will apply to an acquisition transaction in a hostile bid context an analysis similar to that applicable to private placements as a defensive tactic.[2]
- We expect the decision will focus on the potential disclosure of confidential information by insiders and advisers, including the directors on the CanniMed board who represented three Locked-Up Shareholders, and by the former financial advisers to Newstrike. The securities commissions were clearly troubled by the possibility that persons in a special relationship with CanniMed may have shared information with Aurora. Although they were not prepared to go so far as to deem Aurora and the Locked-Up Shareholders to be joint actors, they cleverly laid the problem at the bidder's feet, leaving Aurora to sort out the sources of its information and to disclose it in a document to which director and officer liability attaches.
- We expect the commissions' reasons for not deeming the bidder and Locked-Up Shareholders to be joint actors will provide helpful illumination of this often grey and hazy concept.

[1] See the Davies bulletin dated February 25, 2016, titled *Take-over Bid Code Reset: 50-10-105*.

[2] See the Davies bulletin dated January 12, 2017, titled *If Pills Are Out, Are Private Placements In?*

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