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Capital Markets Tribunal Establishes New Framework for Evaluating Poison Pills

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The Ontario Capital Markets Tribunal recently released its highly anticipated reasons for cease trading a shareholder rights plan adopted by Bitfarms Ltd. (Bitfarms) with a 15% trigger (15% Rights Plan). In *Riot Platforms, Inc. v. Bitfarms Ltd.*, 2024 ONCMT 27, the Tribunal exercised its public interest jurisdiction under section 127(1) of the Ontario Securities Act to cease trade the 15% Rights Plan because it deviated both from the customary 20% trigger contained in virtually all "next generation" Canadian shareholder rights plans adopted in the period after the 2016 amendments to the Canadian take-over bid regime came into effect, as well as from the bright-line 20% threshold in the Canadian take-over bid regime that dates back to 1965.

In *Riot Platforms*, the Tribunal seized the opportunity to establish a new framework for exercising its public interest jurisdiction in circumstances in which there is no established breach of Ontario securities law. In doing so, the Tribunal resolved the divergent approaches that had emerged from decades of past shareholder rights plan decisions of the Tribunal and its predecessor, the Ontario Securities Commission (Commission).

Key Takeaways

- The Tribunal has articulated clearly for the first time the legal test for assessing whether a shareholder rights plan will be cease traded under the Tribunal's public interest jurisdiction on the basis of the "animating principles" underlying the *Securities Act*, including:
  - the purposes of the *Securities Act* set out in section 1.1, being:
    - the protection of investors from unfair, improper or fraudulent practices;
    - the fostering of fair, efficient and competitive capital markets and confidence in capital markets; and
    - contribution to the stability of the financial system and the reduction of systemic risk; and
  - the principles set out in section 2.1 of the *Securities Act* to which the Commission must have regard in pursuing the purposes of the *Act*, being:
    - balancing the importance to be given to each of the purposes of the *Act*;
    - the primary means for achieving the purposes of the *Act*, being: (i) requirements for timely, accurate and efficient disclosure of information; (ii) restrictions on fraudulent and unfair market practices and procedures; and (iii) requirements for the maintenance of high standards of fitness and business conduct to ensure honest and responsible conduct by market participants;
    - timely, open and efficient administration and enforcement;
    - utilization by the Commission of the enforcement capability and regulatory expertise of recognized self-regulatory organizations;
    - the sound and responsible harmonization and coordination of securities regulation regimes;

  - business and regulatory costs, and other restrictions on business and investment activities of market participants, being kept proportionate to the significance of the regulatory objectives sought to be realized; and
  - the facilitation of innovation in Ontario's capital markets.

- The Tribunal held that it is in the public interest to cease trade a shareholder rights plan that does not otherwise contravene Ontario securities law where (i) the applicant demonstrates that the plan undermines, in a "real and substantial way", and with "public effect", one or more clearly discernible animating principles underlying Ontario securities law, and (ii) the respondent does not demonstrate exceptional circumstances that would justify the continuation of the plan.
- The Tribunal further explained that the applicant must present proof that it is "well-grounded, reasonably likely, and not illusory" that the conduct in question will undermine an animating principle in a "serious and non-trivial" way.
- The 15% Rights Plan satisfied the criteria to be cease traded, and was cease traded by the Tribunal one day after the completion of a contested hearing of the matter in July 2024.
- In limiting its articulation of the public interest test to the context of shareholder rights plans, the Tribunal has seemingly left the door open to revisit the public interest standard that applies to a defensive private placement or other defensive tactics that do not contravene the *Securities Act*.
- The Tribunal also left open the possibility that a shareholder rights plan with a trigger below 20% may not be cease traded in exceptional circumstances. Notably, the Tribunal suggested such exceptional circumstances could include the conduct of the bidder, whether the bidder had achieved a "blocking" position, or where the issuer adduces credible evidence of a real and ongoing strategic review process or forthcoming value-enhancing transaction. It will be interesting to see whether these features of the Tribunal's decision give rise to increased litigation concerning shareholder rights plans in the future.
- Going forward, boards of directors should ensure that they make every effort to satisfy the "exceptional circumstances" requirement before adopting shareholder rights plans with sub-20% triggers or other features that depart from the take-over bid regime as a defensive tactic.

Background

Riot Platforms, Inc. (Riot) and Bitfarms are competitors in the Bitcoin mining industry. In 2023 and 2024, Riot submitted several confidential proposals to Bitfarms with respect to a potential business combination of the two companies. Those overtures were unsuccessful.

Throughout the first half of 2024, Riot acquired a toehold position representing just under 15% of the outstanding common shares of Bitfarms and requisitioned a special meeting of Bitfarms' shareholders to nominate new directors for election to the Bitfarms board. In response, on June 10, 2024, Bitfarms announced that it had initiated a strategic review process and had adopted the 15% Rights Plan to ensure that it had sufficient opportunity to complete the strategic review process it was then engaged in. Bitfarms took the position that Riot's toehold position would likely inhibit the strategic review process and prevent Bitfarms from maximizing shareholder value.

Riot applied to the Tribunal under section 127(1) of the Securities Act for an order cease trading the 15% Rights Plan.

Re-examining the Tribunal's Public Interest Jurisdiction

Section 127 of the *Securities Act* empowers the Tribunal to make a wide range of orders "if in its opinion it is in the public interest" to do so. In its decision, the Tribunal confirmed that it may make an order under section 127(1) in the absence of an alleged contravention of Ontario securities laws (with few exceptions) if it is in the public interest to do so. In considering the public interest, the Tribunal is required to have regard to the "animating principles" underlying Ontario securities laws. These principles include:

- the purposes set out in section 1.1 of the *Securities Act* to (a) provide protection to investors from unfair, improper or fraudulent practices, and (b) foster fair and efficient capital markets and confidence in capital markets;
- the fundamental principles that must be applied in carrying out these purposes, as set out in section 2.1 of the *Securities Act*; and
- other fundamental principles that underlie particular provisions of Ontario securities law that are relevant to a given proceeding.

Assessing Conduct Against the Animating Principles

As it explained in *Riot Platforms*, the Tribunal is required to consider animating principles in connection with all proceedings under section 127(1). That being said, context matters. Accordingly, the required analysis may vary between enforcement proceedings and non-enforcement proceedings, and may vary further between different types of non-enforcement proceedings, depending on the matters at issue.

In its recent decision in *Mithaq Canada Inc. (Re)*, 2024 ONCMT 9 (a case involving a request to cease trade a defensive private placement implemented in the face of an unsolicited take-over bid), the Tribunal signalled that it was seeking an opportunity to clarify the appropriate standards against which to evaluate conduct in relation to the animating principles in different contexts.

In *Riot Platforms*, the Tribunal canvassed decades of past shareholder rights plan decisions that applied inconsistent standards in the evaluation of conduct relating to the animating principles underlying the *Securities Act*. For example, certain decisions required conduct at issue to be "abusive" of the animating principles before the Tribunal would intervene, whereas others required conduct that ranged from being "inconsistent with" the animating principles to conduct that "engaged", was "contrary to", "undermined", "offended", "contravened" or resulted in "non-compliance with" the animating principles.

The Tribunal concluded its effort to refine and bring consistency to the relevant standard by holding that, in an application to cease-trade a shareholder rights plan under section 127(1) of the *Securities Act* where a breach of Ontario securities law has not been alleged or established, the applicant must establish that "the conduct undermines one or more clearly discernable animating principles in a real (i.e., well-grounded, reasonably likely, and not illusory) and substantial (i.e., serious and non-trivial) way". The Tribunal held that this standard would bring "some measure of predictability" and would reflect "the cautious approach" it "should adopt" when considering whether to intervene in the capital markets absent a breach of Ontario securities law.

Notably, the Tribunal signalled that motive – meaning the purposes for which a shareholder rights plan was designed or implemented – can be a relevant consideration in assessing such a plan, because "[t]here is a direct connection between the Act's expressly stated purpose of fostering confidence in the capital markets and the motivations behind conduct that risks undermining that confidence".

The Requisite Public Aspect

In addition to the animating principles component of the public interest test described above, the Tribunal held that the applicant must show the necessary "public" aspect is present. In other words, it must be in the public interest to make the requested order. This may be accomplished by establishing that (i) the impugned conduct has a harmful effect on investors generally, the capital markets as a whole or the pool of actual and potential investors in a public issuer, or (ii) the impugned conduct, if condoned, would likely have a negative effect in future transactions.

The Test for a Public Interest Order in the Context of a Shareholder Rights Plan

The Tribunal summarized the appropriate test for an order under section 127(1) of the *Securities Act* to cease trade a shareholder rights plan as follows:

[I]n proceedings where an applicant seeks to cease trade a shareholder rights plan, without establishing that the plan contravenes Ontario securities law, the Tribunal will consider whether the applicant has shown that:

a. the plan undermined, in a real and substantial way, one or more clearly discernible animating principles underlying applicable provisions of Ontario securities law; and

b. the plan's existence causes an effect that has a public dimension, such that it is in the public interest for the Tribunal to intervene.

Assessment of the 15% Rights Plan

The 20% Threshold in NI 62-104

The Tribunal accepted that the 20% threshold that is firmly embedded in the take-over bid regime, as set out in National Instrument 62-104 – *Take-Over Bids and Issuer Bids* (NI 62-104), was an appropriate benchmark in assessing the trigger contained in the 15% Rights Plan at issue. That was so even though Riot had not launched a bid for Bitfarms when it brought its application to the Tribunal. The historical underpinnings of the take-over bid regime demonstrated that a primary purpose of the regime is to provide an orderly process for changes of control of publicly traded companies. The process prioritizes the interests of target shareholders, including by safeguarding transparency, equality of treatment and time to consider alternative offers. It also aims to provide predictability as to when enhanced bidder requirements begin to apply (e.g., insider reporting and early warning reporting).

In describing the architecture of the take-over bid regime, the Tribunal also recognized that the regime contains exemptions, as well as insider reporting and early warning disclosure requirements. These features represent a policy compromise between allowing accumulations of shares up to 20% in the ordinary course, and disclosure to shareholders about "significant market activity". Thus, the take-over bid regime contains elements that "govern accumulations of shares both below and above a 20% threshold."

The Tribunal agreed with Riot and the Commission that the "bright-line" nature of the 20% threshold in Canada's take-over bid regime increases certainty and predictability for market participants, and thereby contributes to the efficiency of capital markets.

2016 Amendments to the Take-Over Bid Regime

In 2016, the Canadian Securities Administrators adopted amendments to Canada's take-over bid regime to enhance the quality and integrity of the regime and strike a new balance between the interests of bidders, on the one hand, and boards of directors of target companies and their security holders, on the other hand. These amendments required, among other things, all non-exempt take-over bids to: (i) include a non-waivable minimum tender condition requiring a majority of securities subject to the bid to be deposited; (ii) be subject to extension by the bidder for an additional period of 10 days after the minimum tender condition has been satisfied and all other terms and conditions of the take-over bid have been complied with or waived; and (iii) remain open for a minimum deposit period of 105 days, subject to limited exceptions.

In *Riot Platforms*, the Tribunal recognized that these amendments were designed, in part, to reduce or eliminate the need for case-by-case assessments of the circumstances in which shareholder rights plans were adopted using the so-called "*Royal Host* factors". A main goal of the 2016 amendments was to "enhance predictability and address many of the reasons that historically had caused issuers to adopt shareholder rights plans". The Tribunal acknowledged that an approach that opened the door to frequent litigation about shareholder rights plans would undo much of what the 2016 amendments sought to accomplish.

For this reason as well, the Tribunal held that it was appropriate to use the 20% threshold in NI 62-104 to assess the 15% Rights Plan. The Tribunal did not, however, rule out the possibility that exceptional circumstances might warrant a different result in a future case.

The Tribunal's decision in *Riot Platforms* is consistent with two previous decisions that cautioned against deviations from the carefully calibrated take-over bid regime that was adopted in 2016. In *Aurora Cannabis Inc. (Re)*, 2018 ONSEC 10, the Commission explained that it "will be a rare case in which a tactical plan will be permitted to interfere with established features of the take-over bid regime". Similarly, in *ESW Capital, LLC (Re)*, 2021 ONSEC 7, the Commission declined to grant a bidder exemptive relief from the minimum tender condition

provided for in the regime. It explained that "[p]redictability is an important aspect of take-over bid regulation and the Commission must be cautious in granting exemptive relief that alters the recently recalibrated bid regime".

In light of these decisions, *Riot Platforms* can be understood as further confirmation by the Tribunal of the important role played by established features of Canada's take-over bid regime in promoting certainty and predictability, as well as the fair and equal treatment of market participants. The Tribunal will not lightly permit deviation from these elements of the regime.

A Departure from the 20% Threshold Requires Exceptional Circumstances

The Tribunal next assessed the circumstances in which a shareholder rights plan may fetter the right of a market participant to acquire up to 20% of the shares of a company without triggering the take-over bid regime. It explained that such restrictions are a "significant departure from long-established market expectations" that would "greatly alter the dynamics of share accumulation by giving the issuer power to influence this process outside of the take-over bid context". Moreover, these restrictions could remove a willing buyer from the market and fail to treat all shareholders equally.

The Tribunal reserved for future cases, however, the possibility that it may not always cease trade shareholder rights plans with sub-20% triggers. Reviewing three decisions issued by securities commissions or tribunals in the period between 2001 (when the take-over bid regime was harmonized across Canada) and 2016 (when the bid regime was rebalanced) in respect of shareholder rights plans with sub-20% triggers, the Tribunal concluded that "an issuer defending a shareholder rights plan that departs from the bid regime's core components should have a high burden".

Bitfarms Failed to Show Exceptional Circumstances

The Tribunal held that Bitfarms failed to demonstrate the existence of any exceptional circumstances that would justify allowing its 15% Rights Plan to continue. The Tribunal found that the following types of conduct did not constitute "exceptional circumstances":

- the rapid accumulation by a strategic buyer of a position in a target company in circumstances in which there was no contravention of applicable securities laws and the integrity of the take-over bid regime had not been undermined; and
- the existence of an ongoing strategic review process initiated by the board of directors, particularly where there was no pending bid and no shareholder approval of the 15% Rights Plan, and the strategic review process had been underway for months with no prospective transaction in sight.

The Tribunal further clarified that "[b]uyers are entitled to engage in rapid and strategic stock accumulation below the 20% bid threshold, as long as they comply with applicable securities laws". Similarly, "buyers are entitled to decide whether to participate in a target's auction or strategic alternative processes and whether to issue public commentary on the governance practices of the companies in which they invest".

The extended duration of Bitfarms' strategic review process was particularly compelling for the Tribunal, given that Bitfarms first received an expression of interest from a third party in April 2024. This was so because the ensuing period to the hearing of Riot's application was approximately equal to the 105-day minimum deposit period prescribed by the take-over bid regime.

The Tribunal held that the evidence adduced by Bitfarms on whether Riot would achieve a blocking position if it increased its shareholdings to more than 15% of the issued and outstanding shares of Bitfarms was not compelling. Therefore, the Tribunal did not express a view on whether the demonstrated existence of a blocking position at a level below 20% might constitute an exceptional circumstance that would permit a shareholder rights plan with a sub-20% trigger to continue in another case.

Since the Tribunal's analysis of this issue was qualitative in nature rather than quantitative, it raises potential uncertainty for future cases as to when a shareholder will be considered to have achieved a blocking position.

In the result, the Tribunal concluded that the 15% Rights Plan of Bitfarms undermined, in a real and substantial way, the animating principles underlying the take-over bid regime. The 15% trigger in the plan was a significant departure from the regime's 20% threshold, and no exceptional circumstances justified that departure. The Tribunal held that, in these circumstances, permitting the 15% Rights Plan to continue would undermine certainty and predictability in Canada's take-over bid regime and weaken confidence in the capital markets.

Notwithstanding these conclusions, the Tribunal suggested that exceptional circumstances might have arisen had there been sufficient evidence to establish that Bitfarms' strategic review process was likely to generate a credible offer or value-enhancing transaction. Moreover, the Tribunal indicated that the conduct of a bidder or the existence of a blocking position could constitute "exceptional circumstances" in the future. Similarly, had the time since Bitfarms first received an expression of interest in April 2024 to the date of the hearing been shorter than the 105-day minimum deposit period, the Tribunal might have reached a different conclusion. Notwithstanding the conclusion reached by the Tribunal in Riot Platforms, shareholder rights plans with sub-15% triggers – or other elements that depart from key features of the take-over bid regime – might become a more prevalent short-term defensive tactic in future contested situations involving exceptional circumstances.

Davies acted for Riot Platforms, Inc. in this proceeding.

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