

Securities Law Newsletter
November 2015
Westlaw Canada

CSA Proposal Ushers in the 120-Day Poison Pill

Ralph Shay, Dentons Canada LLP

In September 2015, Total Energy Services Inc. (Total Energy) announced that it would not be proceeding with its previously announced unsolicited take-over bid for Strad Energy Services Ltd. (Strad), a company listed on the Toronto Stock Exchange. The announcement came on the same day that Strad announced that its board of directors had adopted a shareholder rights plan (poison pill) with a 120-day "permitted bid", noting that this was "the same period of time that the Canadian securities regulators have proposed that a take-over bid must remain open in the regulators' proposed amendments to the Canadian take-over bid regime as published in March 2015." Total Energy stated in its press release that while it "would have been prepared to pursue the Offer in the face of a Strad shareholder rights plan containing more typical "permitted bid" requirements [60 days], Total has concluded that the 120 day period associated with the Poison Pill is inordinately long and exposes Total to an unacceptable level of risk in the context of challenging and uncertain industry and market conditions."

This was the first indication of what could be construed by some as evidential support for securities industry commentators who had expressed the view that the latest proposal of the Canadian Securities Administrators (CSA) to revamp the take-over bid laws was too target-friendly and would discourage hostile bids, to the possible detriment of the shareholders of public companies that were potential bid targets. The recent take-over bid by Suncor Energy Inc. for Canadian Oil Sands Limited may prove to be another example, depending on the course of action Suncor takes in response to a shareholder rights plan (poison pill) introduced by Canadian Oil Sands in the face of the bid and on the result of any regulatory challenge Suncor may undertake.

Background

In March 2015, the CSA published proposed amendments to the take-over bid laws. The proposals were designed to address concerns that had been expressed by securities industry participants regarding the restricted ability of target boards to defend themselves against hostile bids and seek superior alternatives for shareholders. One of these restrictions related to timing; the minimum prescribed bid period of 35 days and

the general reluctance of securities regulators to allow target boards to use poison pills to significantly extend that period were regarded by many as insufficient to allow the boards to properly exercise their fiduciary duties in responding to a bid.

One of the CSA's proposed changes was an increase in the minimum bid period to 120 days (which could be changed to as few as 35 days under specified circumstances, including in the case of a friendly bid or alternative transaction by the target such as a plan of arrangement). This part of the proposal represented a compromise between the Quebec Autorité des marchés financiers (AMF) and the rest of the CSA. Earlier, in March 2013, the AMF had published a proposal that would leave the regulation of take-over defences largely in the hands of the courts, while simultaneously the rest of the CSA had proposed a new regime which would, among other things, allow a poison pill to remain in place for up to 90 days after the earlier of its adoption or the commencement of a take-over bid, and to remain in effect after its approval by shareholders, with subsequent annual shareholder ratification also required.

Since shortly after poison pills were introduced in Canada in the late 1980s, the pills have generally included the concept of the "permitted bid", which would allow bidders to avoid the operation of the pill if their bids contained certain features. These typically include a minimum bid period of 60 days, an irrevocable minimum tender condition of more than 50% of the outstanding shares of the target not owned by the bidder and its joint actors, and a bid extension of at least 10 days following the public announcement that the minimum tender condition had been met. (The CSA, in its latest proposal, adopts the latter two requirements for all non-exempt take-over bids.) Despite the permitted bid's availability to hostile bidders, poison pills have been routinely challenged in hearings before the securities regulators for 24 years.

Transitional Issues

Prior to the latest CSA proposal, the securities regulators have shown little inclination to attach significance to a poison pill's permitted bid conditions in determining how long a poison pill should be allowed to remain in effect. There is now a question of whether the situation might change in light of the 120-day proposal. The comment period on the CSA proposal expired in June 2015, and to date there has been no formal announcement by the CSA of the result of the comment review process. In light of the Canadian Oil Sands poison pill and possibly others to come, securities regulators may be required to take a position on the transitional question.

The implementation of the 120-day proposal will necessitate an amendment to the Ontario *Securities Act* and to current Multilateral Instrument 62-104 – *Take-over Bids*

and Issuer Bids, and as such requires the approval of not just the securities regulators but of other levels of government as well. To allow 120-day permitted bids solely because of the CSA proposal would, in substance, arguably amount to a premature implementation of a change in the law, demonstrating a lack of respect for the mandated legislative process.

On the other hand, securities regulators have not previously based their decisions in this area on any law that restricts the use of poison pills, but rather on the application of a policy statement: National Policy 62-202 – *Take-over Bids – Defensive Tactics* and the exercise of the regulators' public interest jurisdiction. Assuming that the CSA's recent view on a 120-day bid period has not changed, it is arguable that the fact that legislation implementing the 120-day period is not yet in effect should not affect the regulators' ability to apply their cease trade powers differently from in the past in order to reflect their latest assessment of what is in the public interest.

A leading case on poison pills is *Re Royal Host Real Estate Investment Trust*, a 1999 joint decision of the British Columbia, Alberta and Ontario securities commissions. The reasons for the decision in *Royal Host* have figured prominently in virtually every poison pill hearing since their publication, not only due to the fact that they carry the weight of three major securities regulatory authorities but mainly because they provide a shopping list of factors to be considered by the regulators in deciding when a poison pill should be deactivated as against a hostile bid. At the time of the *Royal Host* hearing, the maximum statutory take-over bid period was 21 days, but the securities commissions of British Columbia, Alberta, Ontario and Quebec had agreed on proposed legislation that would increase the period to 35 days. The legislation implementing the longer period was not enacted for almost two years after the hearing. Nevertheless, the proposed change was one of the factors the commissions took into account in deciding how long the poison pill could continue in effect as against the hostile bid.

Moreover, securities regulators have on occasion granted discretionary exemptions based on proposed rule changes.

However, in the June 2014 poison pill case of *Re HudBay Minerals*, the British Columbia Securities Commission explicitly declined to apply either of the then-outstanding CSA or AMF proposals. In that instance, because the poison pill had been approved by the target's shareholders during the course of the hostile bid, implementation of the March 2013 CSA proposal would have allowed the pill to stay in place, subject to annual ratification by the shareholders in subsequent years. Nevertheless, the Commission ruled that it would cease trade the pill if it was still in

effect beyond a specified period, albeit a longer period than normally had been allowed in the past.

Canadian Oil Sands had a shareholder-approved poison pill in place with a normal 60-day permitted bid provision when Suncor announced its unsolicited bid in October 2015. Suncor structured its bid as a permitted bid under that pill. Canadian Oil Sands then introduced a new pill with a 120-day permitted bid. In addition to the issue of whether a law that is still in the proposal stage should be applied, the fact that shareholders had approved the first pill but not the second could be a factor in a proceeding to determine the fate of the second pill.

It also might be noted that any regulatory challenge to the Canadian Oil Sands pill would be expected to take place in Alberta where Canadian Oil Sands is based. The Alberta Securities Commission (ASC) has generally been somewhat more target-friendly in some of its poison pill decisions than other regulators. As an example, the ASC was the first regulator to allow a poison pill to remain in place indefinitely after being approved by the target's shareholders during a hostile bid (in *Re Pulse Data*, 2007).

Until there is some guidance from the securities regulators on their views of 120-day permitted bid provisions prior to the legislative implementation of the current proposals, any predictions of the outcome of potential hearings involving poison pills such as that of Canadian Oil Sands will remain only speculative.