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REGULATORS POISED TO MAKE LIFE DIFFICULT FOR HOSTILE BIDDERS

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The Canadian Securities Administrators (CSA) have published draft legislation that would bring about fundamental changes to the securities regulatory take-over regime in Canada. For almost a quarter of a century, the regulators have generally taken a bidder-friendly approach in the course of their interventions when take-over targets have attempted to defend against hostile bids with shareholder rights plans. The proposed changes, despite leaving the regulators' published policy on take-over defensive tactics intact, would shift much of the advantage away from bidders, with the likely result that there will be fewer hostile bids.

Background

For a number of years, securities industry participants and others have expressed concern about the restricted ability of Canadian public companies to defend themselves against hostile take-over bids. The issues relate to National Policy 62-202 – *Take-over Bids – Defensive Tactics* (NP 62-202) – of the CSA and the manner in which it has been applied by the regulators. NP 62-202 emphasizes shareholder choice and has been used by hostile bidders on numerous occasions to successfully limit the use of shareholder rights plans as a defensive tactic by take-over targets. Detractors of NP 62-202 have argued, among other things, that NP 62-202 has been applied in a manner that impedes the ability of a target's directors to exercise their fiduciary duty to act in the best interests of the target where those interests may call for a strong defence to the hostile bid. For example, the target's management may need more time to find superior alternatives to the bid than the regulators allow, or management may determine that the long-term interests of the target would be better served by mounting a defence that amounts to a "just say no" position with respect to the bid.

In March 2013, the securities regulators responded to these concerns with two alternative proposals for change. One proposal was from the CSA and was confined to shareholder rights plans, the most common Canadian take-over defensive tactic. The other proposal was from the Quebec Autorité des marchés financiers (AMF) and covered defensive tactics generally.

Under the CSA's proposal, a take-over target could keep a shareholder rights plan in place against a hostile bid if the plan was approved by shareholders (excluding the shares held by a current hostile bidder, if any, and its joint actors) within 90 days of its adoption by the board of directors or within 90 days of the commencement of a current take-over bid, whichever was earlier. The shareholder rights plan would have to be approved by the shareholders at each annual meeting in the financial years following the financial year of the initial shareholder approval in order to remain in effect. These requirements would take the form of a new national instrument, and National Policy 62-202 would be amended to exclude shareholder rights plans from its general application.

The AMF proposal would give deference to boards of directors of target companies, limiting intervention by securities regulators to where the target board failed to adequately address conflicts of interest in adopting a take-over defensive tactic, or in circumstances that were abusive of shareholder rights or negatively impacted the efficiency of the capital markets. In addition, the AMF proposed that all take-over bids (other than exempt bids, such as bids that qualified for the normal course purchase or private agreement exemption) would be required to have an irrevocable minimum tender condition of more than 50% of the outstanding shares of the target not owned by bidder and its joint actors, and the bid would have to be extended for 10 days following the public announcement that the minimum tender condition had been met.

The Compromise

The AMF and the rest of the CSA have now agreed on a single proposal that would not change the existing policy on defensive tactics, but rather would address the issues around defensive tactics through amendments to the rules governing take-over bid mechanics. The earlier AMF proposal to require the minimum tender condition and bid extension was not controversial and forms part of the new CSA proposal. It would remove the coercion element from bids, thereby eliminating one of the current justifications for defensive tactics. The other major change would be to increase the time period during which a bid must be outstanding to 120 days, subject to a reduction of that period under certain circumstances.

Specifically, the target's board could choose to designate a bid period of less than 120 days but at least 35 days (the minimum period allowed by the current rules) by issuing a press release to that effect, in which case all contemporaneous take-over bids could obtain the benefit of the shorter period. In addition, a bid period as short as 35 days would be allowed if the target announced that it had entered into an agreement providing for an "alternative transaction", such as a plan of arrangement that would result in the acquisition of the target. There would also be a number of technical amendments to the rules relating to matters such as withdrawal rights in order to properly accommodate the major changes. The CSA is requesting comments by June 29, 2015.

The latest proposal is a compromise that enabled the regulators to arrive at a unified position. It reflects the recognition that regional differences in regulation in this area of the law would be highly undesirable, given that take-over bids are generally made simultaneously in every Canadian jurisdiction.

Observations

The proposal of the mandated minimum tender condition and extension could be of some defensive benefit to a target of a hostile bid, in that removal of the coercive element might cause some shareholders to hold off on tendering during the initial bid period, thereby decreasing the likelihood of the minimum tender condition being met. However, the 120-day bid period would likely play the more significant role in shifting much of the power to the target, as compared to the current regulatory regime.

The implementation of the earlier AMF proposal in its entirety would have made the success of hostile bids highly problematic. In the absence of unusual circumstances, the fate of a defensive tactic would rest with corporate law and the courts, which would give the target's directors the advantage, based on the current case law. In the 2008 case of *BCE Inc. v. 1976 Debentureholders*, the Supreme Court of Canada characterized directors' fiduciary duties as not being confined to short-term profit or share value, but rather looking to the long-term interests of the corporation. The court also stated that there was no principle that, in the exercise of the directors' fiduciary duties, the interests of shareholders should prevail over another set of corporate stakeholder interests.

While the subject matter in *BCE* was not a take-over defensive tactic, there has been no judicial indication that the court's pronouncements in that case would not apply in the context of a hostile take-over bid. The same holds true for the business judgment rule, which the court in *BCE* also strongly reinforced. As a result, it appears likely that successfully attacking a take-over defensive tactic at the court level would be a formidable challenge.

Accordingly, the earlier AMF proposal could be reasonably construed, for practical purposes, as having been decidedly target-friendly. The new CSA proposal for a 120-day bid period represents a compromise with the AMF that maintains shareholder choice but nevertheless represents a major shift in power in the target's direction.

In 2001, at the recommendation of a securities industry committee, the mandatory minimum take-over bid period was increased from 21 days to the current 35 days. It was suggested by some industry observers at the time that the increased period would remove the justification for defensive tactics such as shareholder rights plans. However, the change had little effect on bidders, target boards and the regulators' dispositions of challenges to shareholder rights plans.

The new 120-day proposal, on the other hand, represents a much more dramatic change. If implemented, it will likely deter at least some hostile bids and cause more potential suitors to negotiate with targets in order to reduce the bid period and thereby possibly save financing costs and reduce the time available for competing bids to materialize.

Since NP 62-202 would remain intact under the current proposal, some of the uncertainties that would have been addressed under the CSA's 2013 proposal will remain. It will still be unclear, for example, as to the significance certain securities regulators will attach to shareholder approval of a shareholder rights plan during the course of a hostile bid. Some clarification from the regulators on that question would be helpful.

It is likely that there will be fewer hearings by securities regulators to address shareholder rights plans if the new proposal is implemented, and that in the hearings that do take place, the target would be expected to have even more of an uphill battle than currently, given the length of time it would have to seek alternatives to the bid. Any benefit to bidders in this regard, however, would be outweighed by the increased bid period. All things considered, the proposal shifts the advantage to the targets, and it would be reasonable to conclude that there will be less hostile bid activity in the Canadian market as a result.

A side benefit to the current proposal is that the take-over rules for all the Canadian jurisdictions would be united into a single national instrument. Currently, Ontario's requirements are divided between the Securities Act and Ontario Securities Commission Rule 62-504. The other jurisdictions have uniform rules in Multilateral Instrument 62-104, which would be renamed National Instrument 62-104 and include Ontario under the proposal. This proposed change is consistent with the "platform" approach to regulation currently being developed for the anticipated Cooperative Capital Markets Regulatory System, under which detailed requirements are contained in regulations rather than legislation, enhancing regulatory efficiency and flexibility.