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BC Securities Commission's Red Eagle Mining Decision Engages an Assortment of Issues

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The contest for control of Vancouver-based mineral exploration company CB Gold Inc. did not attract nearly the level of attention of the unsolicited take-over bid by Suncor Energy Inc. for Canadian Oil Sands Limited over the course of the last few months of 2015. But from a securities regulatory standpoint, the issues involved in the Red Eagle Mining/CB Gold/Batero Gold proceeding before the British Columbia Securities Commission (BCSC) were more varied and arguably more noteworthy.

BACKGROUND

CB Gold Inc., which is listed on the TSX Venture Exchange (TSX-V), was the target of two take-over bids, one hostile and one friendly. Red Eagle Mining Corporation launched an unsolicited bid first. At the time of the announcement of that bid, CB Gold already had a shareholder rights plan (poison pill) in place which had been approved by its shareholders.

While the Red Eagle bid was outstanding, CB Gold and Batero Gold Corp. announced that they had entered into a support agreement under which Batero would make a take-over bid for CB Gold. The agreement included covenants of CB Gold not to solicit alternative proposals and to waive its poison pill in connection with the Batero bid, the waiver not to be implemented earlier than two business days before the expiry date of the Batero bid.

In the press release announcing the Batero bid, it was also disclosed that CB Gold had agreed to issue common shares to Batero for cash by way of a private placement, subject to the approval of the TSX-V. The number of shares to be issued in the private placement represented approximately 6.8% of the number of the outstanding common shares of CB Gold before giving effect to the issuance. CB Gold issued another press release the same day announcing the closing of the private placement.

CB Gold and Batero had a shareholder in common who owned more than 10% of the outstanding common shares of each company. It would appear that the Batero bid would automatically fall within the definition of an "insider bid" in Multilateral Instrument 61-101 – *Protection of Minority Security Holders in Special Transactions* (MI 61-101) by virtue of Batero being an "associated entity" of an "issuer insider" of CB Gold, although this analysis does not appear to have been undertaken in the course of the proceedings relating to the bid. Instead, the issue of whether the bid was an insider bid seems to have been debated on the basis of a possible "joint actor" relationship between Batero and the shareholder. In any event, Batero took the position, disputed by Red Eagle, that even if Batero's bid was an insider bid, no formal valuation was required under MI 61-101 because the exemption for "Lack of Knowledge and [board or management] Representation" would apply.

Red Eagle applied to the BCSC for orders in the public interest that trading cease in respect of the poison pill, the shares issued in the private placement to Batero, and the Batero take-over bid, and that the boards of CB Gold and Batero take all steps necessary to reverse the issuance of the shares to Batero in the private placement. Following a hearing, the BCSC cease traded the poison pill and dismissed the remainder of the application.

OBSERVATIONS AND QUESTIONS ARISING FROM THE DECISION OF THE BCSC

The Poison Pill

The cease trading of the poison pill likely was not unexpected by those familiar with previous securities regulatory decisions, particularly those of the BCSC. The pill had been outstanding for 72 days at the time of the hearing, CB Gold was no longer seeking alternative transactions in light of its non-solicitation agreement with Batero, and the regulators generally have not considered it to be their role to interfere with timing advantages that one bidder may have over another. There was no indication that the March 2015 proposal of the Canadian Securities Administrators (CSA) for a 120-day minimum take-over bid period (subject to exceptions) was raised as an argument in the hearing, probably because of its lack of significance in the context of the competing bids.

The BCSC's decision to cease trade the poison pill was premised on a representation to the BCSC by Red Eagle that it would extend its bid for ten days if and when it took up any shares under its bid. The BCSC had imposed the same condition in its 2014 *HudBay Minerals Inc. and Augusta Resource Corporation* decision.

The Private Placement as an Alleged Defensive Tactic

Red Eagle took the position that the private placement to Batero was a defensive tactic that violated the principles of National Policy 62-202 – *Take-over Bids – Defensive Tactics* (NP 62-202), which explicitly includes an issuance of "securities representing a significant percentage of the outstanding securities of the target company" as a possible defensive tactic that may come under scrutiny under the policy. The BCSC rejected this submission, determining that CB Gold was in need of financing at the time of the private placement and that the private placement did not have the effect of preventing the CB Gold shareholders from considering the Red Eagle bid.

Of particular note was the BCSC's pronouncement that "a private placement should only be blocked by securities regulators where there is clear abuse of the target shareholders and/or the capital markets." Three years earlier, in *Inmet Mining Corporation and Petaquilla Minerals Ltd.*, the BCSC granted an application by a hostile bidder for a cease trade order against the target's proposed private placement which the BCSC determined could have had the effect of denying the target's shareholders the opportunity to tender to the hostile bid. The target had publicly announced the intended private placement approximately seven weeks before the announcement of the hostile take-over bid. The BCSC specifically considered the question of whether the private placement was a "bona fide ordinary course financing or an abusive defensive tactic" and went on to state in its reasons that it appeared from the evidence that "the proposed offering was in the ordinary course of business. Certainly there was no evidence that it was an artificial transaction created as a purely defensive measure." (In its *Red Eagle* reasons, the BCSC distinguished *Inmet Mining* on its facts.)

In support of its conclusion that the CB Gold private placement was not abusive, the BCSC pointed out that "the evidence suggested the very real possibility that without the Private Placement, the auction would not have taken place." This is in contrast with the decision of the Quebec Bureau de décision et

de révision in its 2012 decision in *Re Fibrek Inc. and AbitibiBowater Inc.* to cease trade a proposed private placement the specific purpose of which was to procure a take-over bid by the intended private placee to compete with an existing hostile bid. While the CSA has made laudable efforts to achieve uniformity in its approach to the regulation of take-over defensive tactics through compromise and its proposed amendments to the rules governing take-over bid mechanics, it appears that there are and may continue to be areas of divergence.

Putting the Toothpaste Back in the Tube – The Already-Completed Private Placement

In 2010, an application was made to the BCSC for relief pursuant to NP 62-202 in connection with an issuance of shares by Lions Gate Entertainment Corp. that had already taken place at the time of the application and which the applicant alleged was a take-over defensive tactic. The BCSC dismissed the application without formal reasons and issued a press release announcing the dismissal, noting that "the Court is the most efficient forum to resolve the issues." It is probably reasonable to assume that the fact that the shares had already been issued played a role in the BCSC's decision, as there was no clear remedy it could apply under its public interest jurisdiction, such as a cease trade order, even if it had found that the issuance engaged NP 62-202. The matter proceeded to the British Columbia Supreme Court as an oppression action, and the share issuance was upheld, with the court opining that it was established Canadian jurisprudence that defending against a take-over bid was something a target's directors were entitled to do if they reasonably believed that the take-over would not be in the target's best interests. The court's decision was upheld by the British Columbia Court of Appeal.

Accordingly, it would appear that a target that can craft as a defensive tactic a transaction that has already been completed by the time it comes under attack by the hostile bidder (and therefore more likely to be considered by a sympathetic court rather than a bidder-friendly securities regulator) may have a considerable advantage over a target that only relies on a poison pill which can be easily cease traded. The limited enforcement capability of the securities regulators lends support to the position of those who advocate that the regulation of defensive tactics should be a matter for the courts, rather than the regulators, although the fact that the poison pill has been overwhelmingly the defensive tactic of choice in Canada for over a quarter of a century has limited the force of this particular argument.

The BCSC in *Red Eagle* did take jurisdiction over the completed private placement, while acknowledging the questions of whether it had the authority to order the unwinding of the transaction and the possible impact of such an order on an issuer's financial circumstances (e.g. if the proceeds had already been spent) and on its creditors and other stakeholders. These issues were rendered moot by the BCSC's rejection of Red Eagle's objections to the private placement.

The enforcement power of a securities regulator with respect to a completed transaction may be enhanced in a proceeding to review a stock exchange decision, as discussed in the next section.

The Role of the TSX-V

Under TSX-V policies, CB Gold's private placement to Batero required the prior acceptance of the TSX-V. The TSX-V does not have a position on take-over bid defensive tactics equivalent to NP 62-202 (although its policies, referencing NP 62-202, provide that it "may" require shareholder approval of a private placement that appears to be a defensive tactic). The Canadian stock exchanges have historically deferred to the securities regulators on defensive tactic issues, which is reflected in their prescribed procedures for poison pills. If it has appeared there was a reasonable possibility that a proposed transaction that required stock exchange acceptance, such as the adoption of poison pill, may have been undertaken in response to a specific take-over bid that was made or was contemplated, the stock

exchange has normally deferred its consideration pending the outcome of any review of the proposal by the applicable securities regulator under NP 62-202.

Accordingly, a stock exchange's involvement in the private placement process would normally serve to prevent a securities regulator from being placed in the position of having to address a completed private placement in the context of a NP 62-202 proceeding, assuming that the stock exchange was aware of the existence of an actual or threatened hostile bid at the time the proposed private placement came under its review. (This did not apply in *Lions Gate* because the target was not listed on a Canadian stock exchange.) However, the TSX-V conditionally accepted CB Gold's private placement to Batero after the Red Eagle bid had already commenced, permitting the private placement to close on the same day that it was publicly announced and before the BCSC hearing.

Red Eagle did not apply to the BCSC for a hearing and review of the TSX-V's decision. Given the BCSC's own decision on the private placement, a review of the TSX-V's decision almost certainly would have suffered the same fate. It is of interest, however, that for a challenge to a transaction that has already been completed, the process for a review of a stock exchange decision, as opposed to public interest proceeding, provides for the possible availability of a direct remedy for a securities regulator that decides against the stock exchange's decision. Under the British Columbia *Securities Act* and securities legislation of other Canadian jurisdictions, upon a hearing and review of a stock exchange decision the regulator may confirm the decision under review "or make such other decision that the [regulator] considers proper." The BCSC applied that provision in 2002 in *Mercury Partners & Company Inc. and Canadian Venture Exchange Inc.* when, upon concluding that the stock exchange should have required shareholder approval of a private placement, it ordered that the issuer submit the private placement, which had already closed, to its shareholders for ratification and, if shareholders did not ratify it, that the boards of the issuer and private placee take all necessary steps to reverse the transaction.

The Minimum Tender Condition

The Red Eagle take-over bid initially contained a 51% minimum tender condition, but the condition was subsequently removed. CB Gold used the removal as the basis for its argument that the Red Eagle bid was coercive, citing the March 2015 CSA proposal that would make the condition mandatory for all non-exempt bids. The BCSC explicitly elected not to follow the CSA proposal, noting that when there is a large blocking position held by an existing minority shareholder (although the size of the "blocking position" in the case of CB Gold, in combination with the shares held by other CB Gold insiders and Batero, was not clear from the BCSC's reasons or public filings), "the only way to create a viable auction process is to waive the minimum tender condition." Given that this is not an extremely unusual circumstance and in light of the BCSC's view, there may be a question of whether the CSA's proposal should be reconsidered or qualified.

Applicability of MI 61-101

CB Gold was a reporting issuer in Ontario and therefore subject to MI 61-101 directly as well as through Policy 5.9 of the TSX-V Corporate Finance Policies which incorporates MI 61-101. As discussed above, the Batero take-over bid for CB Gold appeared to be an insider bid under MI 61-101 because the bidder was an associated entity of an issuer insider of CB Gold. Batero took the position that if its bid was an insider bid, it qualified for an exemption from the formal valuation requirement in MI 61-101 because Batero had no board or management representation with CB Gold or knowledge of any undisclosed material information regarding CB Gold. Red Eagle took the position that this exemption was not available.

MI 61-101 has not been adopted by the BCSC, and there is no indication that Red Eagle sought relief in Ontario or Quebec with respect to MI 61-101 or that the TSX Venture Exchange considered the formal valuation issue pursuant to its Policy 5.9. The BCSC has regulatory oversight of the TSX-V and might be expected to have given consideration to the formal valuation issue on that basis. As it happened, without deciding the issues of whether the Batero bid was an insider bid and, if so, whether it qualified for a formal valuation exemption, the BCSC concluded that a valuation would provide no benefit over and above the ongoing auction process. MI 61-101 does provide for an "auction" exemption, but it is conditioned on the target having provided all bidders with equal access to itself and information about itself. The BCSC did not make reference to that exemption in its reasons.

Other Disclosure Issues

As is the case in most contests for control of a public issuer, allegations around disclosure figured prominently in the Red Eagle proceeding. Securities regulators have often declared that there is "a difference between perfect disclosure (which no two opposing counsel likely would ever agree upon), acceptable disclosure and material non-disclosure or material misleading disclosure" (originally stated by the Ontario Securities Commission in *Re Standard Broadcasting Corporation Limited* in 1985). When there have been subjective issues pertaining to disclosure in the context of a control battle, the regulators have often taken a step back and determined that the disclosure that was already available to shareholders was sufficient to enable them to make an informed tendering or voting decision, and that it was therefore unnecessary to enter into a comprehensive analysis of the existing disclosure for possible areas of improvement.

The BCSC took this approach to the various disclosure-related allegations levelled by Red Eagle against the Batero bid. It might be noted, however, that Red Eagle was alleging not only deficiencies that could be open to subjective judgment as to their materiality, but also breaches of securities laws of a more black-letter nature.

Included in Red Eagle's allegations were that the directors' circular in respect of the Red Eagle bid and a copy of the shareholder rights plan were filed late, CB Gold failed to file certain material contracts and an exempt distribution report for the private placement, and Batero did not comply with early warning requirements. Regardless of whether or not these allegations were valid, the BCSC declined to make the factual determinations necessary to address them, noting that there was an ongoing public auction and that all material information relating to the relationships among CB Gold, Batero and the significant shareholder they had in common was part of the public record. Accordingly, in the BCSC's view "[t]here was no material prejudice to the CB Gold shareholders or our capital markets arising from the alleged breaches or violations, assuming that they were proven by the evidence."

Some would undoubtedly conclude that there should be little quarrel over a regulatory disposition that leaves the decision entirely up to the shareholders as to which of two bids to choose, without interference from either the target's board or the regulators. However, another perspective is that the disclosure laws, including those relating to early warning and other regulatory filings, are there for a reason and were not intended to be only selectively enforced. In any event, given the requested relief in the application and the BCSC's historic emphasis on shareholders' freedom of choice in the context of a take-over bid, the result of the *Red Eagle* hearing should not have come as a surprise.