FEATURE ARTICLES

CANADIAN SECURITIES REGULATORY AUTHORITIES PROPOSE TWO NEW APPROACHES TO THE REGULATION OF SHAREHOLDER RIGHTS PLANS – A CLASH OF PHILOSOPHIES

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Canada does not have a national securities regulator. Rather, each province and territory regulates capital market activity within its jurisdiction, and provincial and territorial regulators coordinate many of their activities through a national organization called the Canadian Securities Administrators ("CSA").

On March 14, 2013, the CSA[2] and Québec's Autorité des marchés financiers ("AMF")[3] (the AMF also is a member of the CSA) issued alternative proposals to revamp the regime regulating shareholder rights plans (or so called "poison pills") in the context of defensive tactics. The AMF proposal went further in advocating a new approach to regulating all defensive tactics, while the CSA indicated that it would address other defensive tactics as part of an ongoing CSA review.

The Canadian Landscape

In Canada, a board of directors can adopt a shareholder rights plan at any time without prior shareholder approval. Under the rules of the Toronto Stock Exchange and the TSX Venture Exchange, a rights plan adopted in the absence of an existing or impending takeover bid is required to be approved by shareholders within six months of adoption. A rights plan adopted in the face of an actual or announced takeover bid is generally regulated directly by a Canadian securities regulatory authority.

Regardless, when faced with a rights plan, hostile bidders generally seek to effectively terminate rights plans by asking Canadian securities regulatory authorities to exercise statutory powers allowing them to cease trade rights that are issuable under rights plans if to do so would be in the public interest. This public interest discretionary authority (i) is limited by the regulatory objectives of securities legislation in Canada, which is to provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in capital markets, and (ii) has been exercised in the context of rights plans pursuant to the guidance outlined under the CSA's National Policy 62-202 – *Take-Over Bids – Defensive Tactics* ("NP 62-202") and its predecessor.[4]

Past decisions of securities regulators under NP 62-202 and the recent proposals of the CSA and the AMF reflect three philosophical approaches to the regulation of rights plans in the context of defensive tactics:

- Current Principal Approach: Currently, the overriding principle is that the only legitimate purpose of a rights plan is to allow a target board to seek an improved or alternative offer, as each shareholder has an absolute right to accept or reject a bid. As a result, Canadian securities regulators have typically been willing to cease trade rights plans of target companies within 45 to 60 days following the launch of a hostile bid, thereby ensuring that shareholders have the right to tender to a bid. The customary effect of this approach is that the target company is forced into a process which, depending on the time available to the target prior to expiry of the initial bid as well as market and specific industry conditions, usually results in a sale by auction;
- CSA Proposal: The CSA proposal recognizes that a rights plan may be adopted for broader, longer-term purposes when approved by a majority of shareholders (represented to some extent by NP 62-202 itself, which provides that "shareholder approval of corporate action would, in appropriate circumstances, allay"

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2 Proposed National Instrument 62-105 Security Holder Rights Plans, CSA Notice, (2013) 36 OSCB 2643 (14 March 2013).

3 An Alternative Approach to Securities Regulators' Intervention in Defensive Tactics, Autorité des marchés financiers Consultation Paper (14 March 2013).

4 Take-Over Bids – Defensive Tactics, OSC National Policy Statement No 38, 9 OSCB 4255 (1986), repealed by 20 OSCB 3525 (1997).

concerns that actions of a board are abusive of the capital markets;[5] and also represented by a few recent securities regulators' decisions[6]); and

- AMF Proposal: The AMF proposal may be considered to be board-centric or corporate-centric, whereby regulators would defer to the decision of a target board in responding to a takeover bid, provided that the board has in place appropriate safeguards to manage conflicts of interests (an approach more consistent with that of the Delaware courts and the even more deferential approach of the Supreme Court of Canada in *BCE Inc. v. 1976 Debentureholders*[7], which examined the duties owed by directors).

In moving away from historical approaches and principles, the CSA and the AMF proposals would provide directors and shareholders of public companies in Canada with greater flexibility in negotiating with hostile bidders or simply defeating hostile takeover bids.

CSA Proposal

The key aspects of the CSA proposal are as follows:

- rights plans will be effective when adopted by the board of directors but must be approved by security holders within 90 days from the date of adoption or, if adopted after a takeover bid has commenced, within 90 days from the date of commencement of the bid,
- to remain effective, rights plans must be approved annually by majority vote of shareholders,
- material amendments to rights plans must be approved by security holders within 90 days of the date of adoption of such amendments,
- shareholders must be able to terminate a rights plan at any time by majority vote,
- shares held by a bidder and its joint actors are to be excluded from a security holder vote to adopt, maintain, amend or terminate a rights plan,
- a rights plan cannot be triggered as a result of a shareholder vote,
- if a rights plan is waived or modified with respect to a takeover bid, it must be waived or modified with respect to any other takeover bid, and
- enhanced public disclosure will be required at the time of adoption of, and material amendment to, a rights plan.

The impact of the CSA proposal would be dramatic:

- The CSA recognizes that, as a result of its proposal, disputes related to rights plans should rarely be brought before a securities regulatory authority. This should result in a higher level of certainty in the market than is currently the case, as securities regulatory authorities have recently taken conflicting views on when a rights plan "should go" and in some limited instances[8] whether it "should go" at all. Nevertheless, the CSA notes that the securities regulators may intervene if a target issuer engages in conduct that undermines the principles underlying the proposed rule or there is a public interest rationale for the intervention not contemplated by the proposed rule.
- We expect that there would be an increase in proxy fights in connection with takeover bids, more akin to the current situation in the United States.
- While litigation before securities regulatory authorities may diminish, there is little doubt that litigation before the courts related to proxy solicitation/fights would increase.
- Under the current regime, rights plans generally only remain in place for 45 to 60 days following a hostile bid. Under the CSA proposal, one would

5 Notice of National Policy 62-202 and Rescission of National Policy Statement No 38 Take-Over Bids – Defensive Tactics, 20 OSCB 3525 (1997).

6 The Ontario Securities Commission in Neo Material Technologies Inc., Re, (2009), 32 OSCB 6941 [Neo Material], the Alberta Securities Commission in Re Pulse Data Inc. 2007 AB ASC 895 [Pulse Data], and the minority reasons of the British Columbia Securities Commission in Lions Gate 2010 BCSCECCOM 494.

7 The Supreme Court held that as long as the directors' decision is found to have been within the range of reasonable choices that they could have made in weighing conflicting interests, the court will not go on to determine whether their decision was the perfect one (2008 SCC 69 at para 112).

8 See *Neo Material* and *Pulse Data*, *supra* note 6.

expect that right plans would remain in place for a minimum period of 90 days and shareholders together with the board of an issuer may well be able to "just say no." At a minimum, boards would be provided with more time to canvass and consider alternatives.

AMF Proposal

The basic elements of the AMF proposal are as follows:

- provided that the board has in place appropriate safeguards to manage conflicts of interest (such as the establishment of a committee of independent directors being advised by independent financial and legal advisors), deference will be given to the decision of a board, absent unusual circumstances that demonstrate an abuse of shareholders' rights or that negatively impact the efficiency of capital markets; and

- takeover bids will be required to provide for a minimum tender condition similar to that currently required for so called "permitted bids" under rights plans in Canada; that is, shares will not be permitted to be taken up under a takeover bid unless more than 50% of the outstanding securities owned by shareholders, other than the offeror and those acting jointly or in concert with the offeror, have been tendered and if such condition is met, the bid will be required to be extended for an additional 10 days following the public announcement that such condition has been met.

The AMF proposal is an unambiguous rejection of NP 62-202, and its impact would be to give boards significantly more flexibility. The AMF proposal would allow boards to fully consider the long-term interests of a corporation and, subject to the ability of shareholders to persuade the board otherwise or to simply remove a sufficient number of directors, the board of a target issuer would at least in theory be able to "just say no." We note, however, that the protection of investors and fostering fair and efficient markets and confidence in the markets are the overlying principles that securities regulatory authorities consider in connection with the exercise of their public interest discretionary power to cease trade rights plans. The regulators' focus largely will continue to be on the impact that a decision of a board will have on the capital markets or shareholders. Accordingly, while a target board could follow a proper process and reach a decision to adopt a rights plan consistent with the exercise of its fiduciary duties, such a decision could still be challenged as impacting negatively on the efficiency of the capital markets or possibly as effecting an abuse of security holders' rights. As a result, it may well be that additional criteria will be required to be enumerated in order to ensure that the AMF's corporate/board centric approach is effective.

Put another way, if a board of a target issuer determines, after adopting and adhering faithfully to a pristine process, that it should "just say no" and this goes on for several months, what would the AMF do? It is interesting to note that a senior representative of the AMF in a discussion of the impact of the AMF proposal was quoted as saying: "This does not mean in my mind that a board would be in a situation to just say no and just say no forever."[9] Market participants may well need additional guidance in order to better understand the basis upon which regulators would cease trade a rights plan under the AMF proposal or, in other words, when "unusual circumstances" might exist that would require the imposition of a cease trade order that would effectively terminate the rights plan.

Conclusion

The CSA and AMF proposals provide a forum for discussion on the issues relating to the regulation of defensive tactics in Canada. This presents a unique opportunity to Canadian market participants and practitioners to shape a key aspect of the regulation of the capital markets. While we have no doubt that there will be significant debate and disagreement among market participants on the way forward, we are hopeful that sufficient consensus can be reached in order for a new approach to be adopted on a timely basis that better protects investors and fosters fair and efficient capital markets and confidence in such markets. McMillan LLP submitted a comment letter to both the CSA and AMF proposals and copies are available upon request.

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9 Jeff Gray, "Canada's Securities Regulators Plan A More Potent Poison Pill" (February 2013) online: The Globe and Mail http://www.theglobeandmail.com/report-on-business/canadas-securities-regulators-plan-a-more-potent-poison-pill/article9050871/.