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The take-over bid regime after two years

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It has now been over two years since Canada's take-over bid regime was revamped to provide for a minimum 105-day bid period, a mandatory 50% minimum tender condition and a 10-day extension once the minimum tender condition has been satisfied.

There were a number of unanswered questions about the new regime following its adoption. Two key questions were (i) whether the 105-day minimum bid period would have a chilling effect on hostile bids; and (ii) how would rights plans be treated by securities regulators under the new regime?

Developments in 2018 may suggest answers to both of these questions.

Fewer hostile bids?

To date in 2018, there have been only five hostile bids, and three in all of 2017. Although it's still too early to draw any definitive conclusions, the number of bids in 2017 and 2018 is below the average over the past 10 years. While the new 105-day minimum deposit period may be one factor that accounts for the decline, other factors may include a decrease in the number of listed companies and a slowdown in the mining sector.

Source: Kingsdale Advisors

Changes to rights plans?

At the time the new bid regime was adopted, Canada's securities regulators were unable to find common ground on reforms to the regulation of defensive tactics, including shareholder rights plans. The absence of consensus left open the question of how regulators called upon to hear challenges to shareholder rights plans would deal with them in light of the new regime.

The general market expectation was that, absent unusual circumstances, rights plans would no longer be relevant in providing targets with more time to respond to a bid than the 105-day statutory minimum deposit period. Market participants also thought that rights plans would still play a role in preventing "creeping" take-over bids over the 20% threshold – such as normal course market purchases of up to 5% per year, private agreement purchases from five or fewer sellers at a price not greater than 115% of market price, and the ability to purchase 5% of the outstanding shares during the course of a take-over bid. In addition, many expected that rights plans could continue to be used, as they have been for years, to discourage "hard" or irrevocable lock-up agreements between the bidder and target shareholders by deeming shares that were subject to a hard lock-up to be beneficially owned by the bidder, thereby counting towards whether the 20% bid threshold under the rights plan was triggered.

Some of these expectations were called into question in the first poison pill decision rendered under the new regime. On March 15, 2018, the Ontario Securities Commission (OSC) and the Financial and Consumer Affairs Authority of Saskatchewan (FCAAS and, together with the OSC, the Commissions) issued their reasons for cease trading a tactical shareholder rights plan that CanniMed Therapeutics Inc. (CanniMed) had adopted in response to a hostile bid by Aurora Cannabis Inc. (Aurora).

The rights plan deemed Aurora to beneficially own all shares subject to lock-up agreements – regardless of whether they were hard lock-ups or soft lock-ups – the distinction being that a soft lock-up agreement can be terminated by the locked-up shareholder in the event of a financially superior competing proposed acquisition of the target company. Although Aurora owned no shares of CanniMed directly, it was deemed for purposes of the rights plan to beneficially own 38% of the outstanding shares subject to the hard lock-ups it had entered into with four CanniMed shareholders. The Commissions found that the rights plan was principally designed to protect CanniMed's proposed acquisition of Newstrike Resources Ltd. (Newstrike) that it was simultaneously pursuing and to resist the Aurora bid (which was conditional on the Newstrike acquisition not proceeding), and that the rights plan was not being used to seek higher bids for CanniMed.

After the rights plan was cease traded, Aurora was able to avail itself of the ability to acquire up to an additional 5% of the outstanding shares through market purchases during the course of its bid.

The Commissions could have struck down the rights plan on the narrow ground that the prohibition of all lock-ups – both hard and soft – in the circumstances where CanniMed was not seeking higher bids was inappropriate. Instead, the Commissions used language in their decision that raises broader policy questions.

The Commissions stated that tactical rights plans "should not generally be utilized to deem a bidder to beneficially own locked-up shares in circumstances where they would not be deemed to be joint actors under the applicable rules." The Commissions had determined that Aurora and the locked-up shareholders were not joint actors. The Commissions added 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 such as the opportunity for bidders and shareholders to make decisions in their own interests regarding whether to tender to a bid by entering into lock-up agreements of the kind under consideration in this case."

These statements cast doubt as to whether any rights plan can be used to restrict the use of hard lock-ups or the ability of a bidder to acquire up to an additional 5% of the outstanding shares during the course of the bid. They also suggest that tactical rights plans adopted in the face of a bid may be accorded less deference than strategic rights plans that have been previously approved by shareholders.

Under the new bid regime, hard lock-ups are less threatening to a target than they once were. Prior to the bid amendments, a bidder could waive any minimum tender condition in its bid and take up the locked-up shares at the expiry of the bid. This had the result of discouraging superior proposals, since the superior proposal could be frustrated by the hostile bidder acquiring the locked-up shares at the expiry of its bid, thereby preventing the superior proposal from meeting its minimum tender condition or voting approval threshold.

Now that the new bid regime requires that a bid be accepted by 50% of all shareholders other than the bidder and its joint actors, this risk has been substantially mitigated, since the bidder cannot acquire the locked-up shares unless the minimum tender condition has been satisfied. Nevertheless, hard lock-ups (which typically include a covenant to vote against any competing transaction) can still constrain the ability of a target to find alternatives to a hostile bid. For example, if the bidder and the locked-up shareholders collectively own one-third of the shares, they could prevent the approval of a higher-valued alternative transaction such as an arrangement that requires the approval of two-thirds of shareholders. The covenant to vote against competing transactions can also extend for months, putting a chill on other acquisition proposals even if the original bid fails.

Accordingly, there still appears to be a legitimate basis for rights plans to restrict the use of hard lock-ups, at least in certain instances. It will be interesting to see what securities regulators decide in subsequent cases. It is possible that CanniMed will be limited to its facts.

Issuers may wish to consider adopting a strategic rights plan and having it approved by shareholders at their annual meetings, in the hope that such plans will have a better chance of withstanding regulatory scrutiny than a tactical plan.

Finally, we note that it is unclear whether all securities regulators will approach these questions in the same manner. In particular, the Autorité des marchés financiers made clear in a consultation paper released in 2013 that it was far more open to the use of defensive tactics than other members of the CSA.

CanniMed is only the first rights plan decision under the new regime. The fundamental question that still remains to be answered is whether securities regulators will permit traditional rights plans, and all the protections they afford, to remain in effect for the 105-day deposit period, or if the new regime has changed the way regulators view rights plans and how they should operate, particularly after a bid has been launched.