mcmillan

Date June 14, 2013

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
New Brunswick Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Northwest Territory
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Nunavut

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Corporate Secretary
Autorité des marchés financiers
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Dear Sirs/Mesdames:

Re: Comments with respect to proposed National Instrument 62-105 *Security Holder Rights Plans* (the "**Proposed Rule**") and proposed Companion Policy 62-105CP *Security Holder Rights Plans* (the "**Proposed Policy**")

Comments with respect to consultation paper of the *Autorité des marchés financiers* ("**AMF**") entitled "An Alternative Approach to Securities Regulators' Intervention in Defensive Tactics" (the "**AMF Proposal**")[1]

We are writing in response to the request for comments by the Canadian Securities Administrators (the "**CSA**") with respect to the Proposed Rule, the Proposed Policy and proposed consequential amendments (collectively, the "**CSA Proposal**"). We are also writing in response to the request for comments by the AMF with respect to the AMF Proposal. In light of the fact that there is significant overlap between our responses to the CSA Proposal and the AMF Proposal, we believe that it is best to combine our responses in one submission. Nevertheless, if one wishes to focus merely on our response to the CSA Proposal, please review Parts I, II and III of this submission; and if one wishes to focus merely on our response to the AMF Proposal, please review Parts I and Part IV below.

In Part I of this submission, we review the current approach to the regulation of defensive tactics with a particular focus on the objectives of, and historical policy basis for, such approach. We also consider the changing circumstances since the adoption of National Policy No. 38 *Take-Over Bids – Defensive Tactics* ("**NP 38**") on or about August 1, 1986; which policy was not substantively different than its successor, National Policy 62-202 *Take-Over Bids – Defensive Tactics* ("**NP 62-202**"). We believe that this review is critical to the formulation of a response to each of the CSA Proposal and the AMF Proposal. In Part I, we conclude by suggesting an alternative approach to that of the AMF and CSA, which we believe may better address the relevant policy concerns. In Part II of this submission, we provide specific suggested revisions to the Proposed Rule and the Proposed Policy which we believe are necessary for such regulations and policy to be internally consistent and to meet the objectives thereof as outlined in the CSA Proposal. In Part III, we respond directly to certain questions set out under "Request for Comments" in the CSA Proposal, and in Part IV we respond directly to certain questions set out under "Request for comment" in the AMF Proposal.

PART I: BACKGROUND – POLICY CONSIDERATIONS – A POSSIBLE THIRD APPROACH

Genesis of Canadian takeover bid regime

As you know, the origin and basis of the takeover bid regime in Canada is the Kimber Report which was released in March 1965.[2] At the time of the Kimber Report, takeover bids were unregulated; however, a voluntary code was followed by some bidders but many bidders chose to follow their own path.[3] The authors of the Kimber Report (the "**Kimber Committee**") noted

[1] *An Alternative Approach to Securities Regulators' Intervention in Defensive Tactics*, Autorité des marchés financiers Consultation Paper (14 March 2013) [*AMF Proposal*].

[2] Province of Ontario, *Report of the Attorney General's Committee on Securities Legislation in Ontario*, March 1965 [*Kimber Report*].

[3] *Ibid* at para 3.06 and 3.10 ("In Canada, as in the United Kingdom, the necessity of regulating take-over bids was recognized by a responsible and influential group of associations who prepared and issued in 1963 'A Recommended

that their recommendations were designed to protect the general public while providing minimum interference with the takeover bid mechanism: [4]

> "The Committee's recommendations concerning the adoption of a mandatory statutory code pertaining to take-over bids are made on an analytical basis designed to protect the general public by averting potential abuses while impeding as little as possible the use of the take-over bid technique."

In commenting on the primary objective of its recommendations and therefore the primary objective of takeover bid legislation, the Kimber Committee stated:[5]

> "The Committee has concluded that the primary objective of any recommendations for legislation with respect to the take-over bid transaction should be the protection of the bona fide interests of the shareholders of the offeree company. Shareholders should have made available to them, as a matter of law, sufficient up-to-date relevant information to permit them to come to a reasoned decision as to the desirability of accepting a bid for their shares. In arriving at its conclusions, however, the Committee attempted to ensure that its recommendations would not unduly impede potential bidders or put them in a commercially disadvantageous position vis-à-vis an entrenched and possibly hostile board of directors of an offeree company."

The thrust of the proposed legislation was to regulate the activities of the bidder. The Kimber Committee was clearly focused on protecting the interests of shareholders by ensuring that shareholders were provided with sufficient information and time in order to enable them to make a reasoned decision as to whether to accept or reject a takeover bid:[6]

> "... the principal purpose justifying the statutory code regulating take-over bids is to ensure that the shareholders of the offeree company are given adequate relevant information and a reasonable period of time within which to assess such information."

It is not clear why the objectives of legislation meant to regulate the activities of a bidder and establish a framework for offers to shareholders should be the primary guiding principle for the regulation of defensive tactics initiated by boards and management of target corporations. While there is no doubt that the Kimber Committee believed that takeover bids should be made directly to the shareholders and not the target company,[7] the Kimber Report was not concerned with, and

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Code of Procedure' to be applied in connection with Take-over Bids...[t]his voluntary Code appears not to have been followed in many cases and therefore in order to achieve full disclosure on an equitable basis, the Committee recommends that it be supplanted by legislative measures applicable, to the extent permitted by constitutional limitations, to all take-over bid transactions made or carried out in Ontario").

[4] *Ibid* at 3.07.

[5] *Ibid* at 3.10.

[6] *Ibid* at 3.15.

[7] *Ibid* at 3.13 ("While in the majority of cases the interests of all parties concerned would best be served by an initial approach to the directors of the offeree company, there are many instances when an approach by a bidder to the directors of an offeree company or to a control group would hinder the success of a potential bid which might well be advantageous

did not address, defensive tactics. In fact, the emergence of defensive tactics does not appear to have been commented on or directly addressed by securities regulatory authorities until the 1983 decision of the Ontario Securities Commission (the "**OSC**") in *Exco.*[8]

Background to NP 38 and the regulation of defensive tactics

In *Exco*, Exco Corporation Limited ("**Exco**") gave notice of a stock exchange takeover bid to purchase all of the issued and outstanding common shares of Nova Scotia Savings & Loan ("**NSSL**") at $21.50 per share. However, before Exco could make any purchases under the bid, NSSL announced that Halifax Development Holdings Limited ("**HDHL**") proposed to make an offer to purchase all of the outstanding NSSL common shares at a price of $23.00 per share. NSSL also announced that it had completed a private placement of 293,000 common shares and had issued 201,000 common shares pursuant to the exercise of employee stock options. These additional 494,000 common shares increased the number of outstanding shares of NSSL from 1,120,000 to 1,614,000. After seeking the necessary approvals, Exco ultimately withdrew its stock exchange bid and proposed to commence a circular takeover bid pursuant to the *Securities Act* (Ontario) (the "**Act**"). As part of this process, Exco made an application to the OSC for an order that its proposed takeover bid was not required to be extended to the holders of the 494,000 shares. The OSC denied Exco's application, as it was reluctant to make a determination of the share issue without a proper hearing; the validity of the share issue was the subject of an action before the Nova Scotia Supreme Court.[9]

In reaching its decision, the OSC gave notice that it had initiated a "staff project", the result of which would be a policy to provide guidance on the "status of shares issued by a target company in the course of a take-over bid".[10] The OSC issued a request for comments in March 1984, in which it outlined the basis of a new policy statement. Following a review of the "1973 Report on Mergers, Amalgamations and Certain Related Matters" of the Ontario Select Committee on Company Law, the United Kingdom City Code on Take-Overs and Mergers and the 1983 Report of the U.S. Securities and Exchange Commission's Advisory Committee on Tender Offers, the OSC noted that it was considering a policy statement to regulate the use of takeover bid defensive tactics by prohibiting a target board from doing any of the following during a takeover bid without the approval of a majority of shareholders at a special meeting called for such purpose:

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to the general body of shareholders of the offeree company and indeed, in some cases, would virtually ensure its failure. As a result, we do not recommend the adoption of a rule requiring a take-over bid to be submitted first to the directors of the offeree company").

[8] 1983 OSCB 3263 (October 7).

[9] *Exco Corporation v Nova Scotia Savings and Loan Company* (1987), 78 NSR (2d) 91, 1987 CarswellNS 44 (Richard J) [*Exco*].

[10] *Supra* note 8 at 3266.

- either issuing any securities of the target or issuing securities representing more than a fixed percentage of the target securities that would be outstanding following the issuance of such shares;

- entering into contracts other than in the ordinary course of business; or

- effecting any other material change to the issuer out of the ordinary course of its business by any means.

The OSC also noted that it was considering having these prohibitions apply to defensive tactics used in anticipation of a takeover bid if the target board had reason to believe at the time that a *bona fide* offer was imminent. The comment letters in response to the March 1984 request for comments outlined various concerns, including:

- it was noted that the shareholder approval technique was impractical and "as has been the experience in the U.K." such technique would not be used;[11]

- it was recommended that the OSC reserve the right to waive the requirement for shareholders' approval where actions being taken during a takeover bid have a legitimate corporate purpose;

- it was feared that, by prohibiting only certain kinds of conduct, any conduct not specifically prohibited would be considered acceptable; the "code of conduct" was viewed as being arbitrary and it was recommended instead that the OSC remain flexible and consider each case on its merits;

- it was noted that any fetters on the discretion of directors would only be appropriate where the potential for abuse significantly outweighed all other considerations - reliance on directors' duties as the foundation of shareholders' protection should not be tampered with; and

- it was noted that, except with respect to the issuance of shares, the approach of the US Securities and Exchange Commission's Advisory Committee, that other actions should be tested against the business judgment rule, or directors' duties at corporate law, was preferred.

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[11] We understand that the shareholder approval technique is rarely, if ever, utilized in the UK. In the UK, takeovers are regulated by *The Code on Takeovers and Mergers* (UK) (10th ed, 2011) [*City Code*], which requires shareholder approval to implement any defence based on the fundamental principle that the offeree board should be prohibited from taking any action without the approval of the shareholders in a general meeting, which could result in the frustration of a *bona fide* offer (*City Code* Rule 21.1, which now sets forth the general non-frustration prohibition previously contained in the General Principle 7 of the previous edition of the *City Code*) – correspondingly, for all practical purposes defensive tactics are also rarely, if ever, utilized in the UK.

Following a review of such comment letters, the OSC published a draft policy on December 7, 1984.

The December 1984 draft policy included much of the core policy rationale underlying NP 38[12] and noted that it was inappropriate to specify a code of conduct for a target board. The listed defensive tactics that were outlined on an inclusive basis that may elicit regulatory review were limited to the issuance of a "significant percentage" of securities without prior shareholder approval and management contracts that may appropriate a portion of proceeds that might otherwise go to shareholders. In response to the December 1984 draft policy, a large public company noted in its comment letter the following:[13]

- requiring shareholder approval in order to issue securities representing a significant percentage of outstanding securities would be removing one of the few effective defensive techniques available;
- it was recommended that shareholder approval of takeover bids should be considered as this would provide a better balance of power between the bidder and target corporation;
- it was debatable that takeover bids were always directed at inefficient management;
- the policy statement appeared, wrongly, to have as its sole objective to make available to shareholders the best price currently available without regard to the long-term best interests of the corporation, its shareholders, employees or community at large; and
- the policy may prevent a corporation from proceeding with proper contracts or options that it would have otherwise done in the normal course.

On February 14, 1986, the OSC published a substantially redrafted policy which was very similar to NP 38. The listed defensive tactics that were outlined on an inclusive basis that may elicit regulatory review were the same as now set out in NP 62-202. The comment letters in response to the February 1986 draft policy highlighted the following issues and concerns:

- a law firm noted that the general language of the policy would make it unclear in what circumstances the OSC would consider defensive measures taken by the board to be objectionable, and that no formal policy would be better than an ambiguous one. In addition, it was noted that the policy would place too great a burden on directors who have initiated a course of conduct in good faith;

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[12] Including the principles set out in Maxims 1, 3 and 5 under "NP 62-202" of Part I below.

[13] This was the only substantial comment letter received by the OSC in response to the December 1984 draft policy.

- a significant Canadian company noted that the policy appeared to require the board to make an application to the OSC, on notice to interested parties, or to hold a shareholders' meeting to approve the action; the delays from this would be detrimental to the interests of the corporation and is an unwarranted restriction on the actions of a corporation; and

- Consumer and Corporate Affairs Canada ("**CCAC**") had a fundamental concern that managerial defensive tactics may interfere with the market for corporate control, adversely affect economy-wide efficiency and hinder the allocation of corporate assets to their highest valued uses. CCAC favoured policies restricting managerial takeover defences as much as possible. CCAC supported the policy's recognition of the importance of shareholder suffrage, and recommended that regulators implement rules specifically governing the delegation of management authority to implement types of defensive tactics prior to shareholder approval. CCAC had further concerns that the OSC had not explicitly addressed issues relating to "poison pills".

On August 1, 1986, the CSA adopted the policy and it was issued as NP 38, with no substantive changes other than a change which provides that there may be circumstances where prior shareholder approval of corporate action would not allay the public interest concerns of the CSA.[14]

It is somewhat surprising that, after nearly 30 years, many of the comments made in respect of the prior draft policies are hauntingly familiar and continue to resonate.

Without clearly articulated reasons by the OSC for why changes were made to prior draft policies, we think it would not be prudent to provide our own reasoning. It is clear, however, that in comparing the initial March 1984 request for comments to NP 62-202, there is a consistent theme that shareholder approval can "cleanse" a defensive tactic. Also, it is clear that defensive tactics with which the OSC was concerned extended from private placements to a broader category of transactions – but not golden parachutes specifically.

In order to better understand the policy rationale underlying NP 38, it is also important to understand the legal and regulatory environment in which NP 38 was issued:

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[14] Under item 3, "However, the Commission wishes to advise participants in the capital markets that it is prepared to examine target company tactics in specific cases to determine whether they are abusive of shareholder rights. Prior shareholder approval of corporate actions would allay such concerns." was changed to "However, the administrators wish to advise participants in the capital markets that they are prepared to examine target company tactics in specific cases to determine whether they are abusive of shareholder rights. Prior shareholder approval of corporate action would, <u>in appropriate cases</u>, allay such concerns." [Emphasis added.]

No rights plans in Canada: The first rights plan would not be issued in Canada until 1988, although rights plans had been issued in the United States as early as 1983.[15]

Leading U.S. decisions relating to defensive tactics were only recently decided: The *Unocal* decision was issued in June 1985 (prior to NP 38 but following the commencement of the OSC's initiative) and confirmed the enhanced scrutiny test for defensive tactics recognizing the inherent conflicts that directors face in the context of takeover bids.[16] *Revlon*, issued in March 1986, stated that if a board has decided to sell a company, it then could no longer assert that there was a threat to corporate policy and effectiveness and therefore its role changed to that of an auctioneer.[17]

Existing case law in Canada was unsettled regarding the exercise of a board's fiduciary duty in the context of a takeover bid:[18] In fact, it was argued at the time that Canadian jurisprudence was result oriented and therefore consistent with NP 38.[19] Alternatively, it was argued that the relevant case law was "in a confused state".[20] In *Hiram Walker*,[21] the court held that the sole and primary objective of the directors was to ensure that as much as possible of all economic value go to all shareholders, and that directors should take all reasonable steps to maximize value for all shareholders. This approach appears inconsistent with *Exco*, where the court held that any finding of self interest on the part of directors would be fatal regardless of whether their primary purpose was a proper purpose. Furthermore, the approach then recently recognized in United States jurisprudence, that the standard for measuring the discharge of a board's duties is lessened if action is undertaken under the direction of independent directors, was not yet discussed in Canadian jurisprudence.[22] Moreover, it was clearly not settled law that a board's duty was owed to the corporation as opposed to the shareholders.

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[15] Steven J O'Melia, "Current Trends and Future Opportunities in Corporate Securities Issues – Shareholder Rights Plans", (January 1990) at 1-2 online: <http://www.millerthomson.com/assets/files/article_attachments/Current%20Trends%20Shareholder%20Rights.pdf>.

[16] *Unocal Corporation v Mesa Petroleum Co*, 493 A.2d 946 (1985) (Del Sup Ct) [*Unocal*].

[17] *Revlon Inc v MacAndrews & Forbes Holdings*, 506 A.2d 173 (1986) (Del Sup Ct) [*Revlon*].

[18] Director good faith was considered greatly important in several cases: see *Teck Corporation Limited v Millar* (1972), 33 DLR (3d) 288 at 315, 317 (BCSC) [*Teck*]; also see *Hogg v Cramphorn*, [1967] 1 Ch 254. Compare *Exco*, *supra* note 9 (conduct that ended an auction was held to be improper) and *Re Olympia & York Enterprises Ltd v Hiram Walker Resources Ltd* (1986), 37 DLR (4th) 193 at 194 (Ont HCJ) aff'd (1986), 37 DLR (4th) 193 (Ont Div Ct) (directorial conduct resulting in a higher offer was held to be proper) [*Olympia*].

[19] Stanley M Beck & Rob Wildeboer, "National Policy 38 as a Regulator of Defensive Tactics" in *Meredith Memorial Lectures* (Cowansville, Que: Yvon Blais, 1987) 119 at 134.

[20] Joseph Groia & Sheila Clark, General Counsel's Office, Ontario Securities Commission, "Current Issues in Take-over Bids" (1987) at B-10.

[21] *Olympia*, *supra* note 18 (Ont HCJ).

[22] Ralph L Simmonds, "Changing the Regulation of Defensive Tactics in Canada" in *Meredith Memorial Lectures* (Cowansville, Que: Yvon Blais, 1987) 157 at 168.

Oppression remedy was not being used as a tool to enhance shareholder rights for public companies: In 1986, the oppression remedy was still viewed as a relatively new remedy that provided Canadian judges with significantly expanded powers to intervene in corporate affairs on behalf of minority shareholders. While the remedy was emerging as an important aspect of corporate law, the courts had given relatively little guidance on how it would apply, and had yet to fully explore the scope of the remedy.

Shareholder activism was in its infancy:[23] There was little risk of institutional shareholders or hedge funds taking steps to replace a board that was not performing. That is, there was very little risk that shareholder activism (or, more particularly, a proxy fight) could act as a discipline on corporate management.

Corporate governance standards were substandard: The significant changes to corporate governance since 1986, including the promulgation of Multilateral Instrument 61-101 *Protection of Minority Security Holders in Special Transactions* ("**MI 61-101**"), have been adequately summarized in the AMF Proposal.[24]

Accordingly, the legal and regulatory environment in which NP 38 was adopted was fundamentally different than the current environment. In 1984-1986, the concern with respect to defensive tactics was not focused on rights plans. In today's environment, shareholders of public companies have significantly more tools available to them than in 1986 to protect their interests, and directors of public companies are subject to different standards in respect of the fiduciary duty owed as well as greater corporate governance disclosure and regulatory rules. Such significant differences should at the very least lead regulators, as recognized in the CSA Proposal and the AMF Proposal, to review the current approach.

NP 62-202[25]

In reviewing NP 62-202, it is important to acknowledge that the Policy should be reflective of rules that would be consistent with a securities regulatory authority exercising its public interest discretion, which discretion is limited by the regulatory objectives of securities legislation: "to provide protection to investors from unfair, improper or fraudulent practices; and, to foster fair and efficient capital markets and confidence in capital markets."[26] Accordingly, the policy must be focused on results, or, in other words, the impact of the actions of a target on the capital markets.

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[23] Paul Gompers, Joy Ishii & Andrew Metrick, "Corporate Governance and Equity Prices" (2003) 118:1 Quarterly Journal of Economics 107 at 108; [Bengt Holmstrom & Steven N Kaplan, "Corporate Governance and Merger Activity in the U.S.: Making Sense of the 1980s and 1990s" (April 2001) NBER Working Paper No 8220 at 4.]

[24] *AMF Proposal*, *supra* note 1 at 11-12.

[25] In light of the fact that NP 38 is in substance the same as NP 62-202 we will refer to NP 62-202 going forward.

[26] *Securities Act*, RSO 1990, c S.5, s 1.1.

We accept the articulation of the core underlying policies of NP 62-202 as set out in six maxims by Messrs. Beck and Wildeboer[27] and as outlined in the AMF Proposal.[28] We will review each core principle and consider whether in our view it has withstood the test of time and remains consistent with the public interest:[29]

1. "Takeover bids have an important role in the economy, for both economic and legal reasons."

The CSA noted in NP 62-202 that takeover bids "play an important role in the economy by acting as a discipline on corporate management and as a means of reallocating economic resources to their best uses". This proposition was subject to significant debate at the time and remains so today. On one side of the debate, commentators argue that takeover bidders are attracted to poorly performing organizations that they can acquire at under-valued prices, replace incumbent management, and achieve efficiency improvements. Management are therefore incentivized to maximize value in order to avoid losing their positions following a takeover.[30] On the other side of the debate, commentators have argued that the economic evidence does not support the disciplinary and asset reallocation effects of takeover bids for many reasons, including the fact that apparently well managed companies are also subject to takeover bids and following such bids management are not replaced.[31] In the words of Professor Simmonds, "[t]he disciplinary explanation in fact cannot be considered to be cogently established."[32] We would also note that shareholder activism may now be a more efficient and cost-effective tool in acting as a discipline on corporate management.

2. "Target management is in a conflict of interest situation when facing a hostile bid."

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[27] Beck, *supra* note 19 at 121.

[28] *AMF Proposal, supra* note 1 at 5.

[29] *Ibid*.

[30] Henry G Manne, "Mergers and the Market for Corporate Control" (1965) 73:2 The Journal of Political Economy 11; Keitha Dunstan, *Corporate Acquisitions: Motivation and Consequence* (Working Paper, Queensland University of Technology School of Accountancy, 1999); Barry D Bayslinger & Henry N Butler, "Antitakeover Amendments, Managerial Entrenchment and the Contractual Theory of the Corporation" (1985) 71:8 Va L Rev 1257; Paul A Pautler, "Evidence on Mergers and Acquisitions" (2003) 48:1 Antitrust Bulletin 119; Andrei Shleifer & Robert W Vishny, "Value Maximization and the Acquisition Process" (1998) 2:1 The Journal of Economic Perspectives 7; David J Denis & Timothy A Kruse, "Managerial Discipline and Corporate Restructuring Following Performance Declines" (1998) 55:3 Journal of Financial Economics 391; Cathy A Enz & Mark D Fulford, "State anti-corporate takeover laws: issues and arguments" (1995) 7:2 Journal of Managerial Issues 142; Holmstrom & Kaplan, *supra* note 23; Mark R Gillen, "Economic Efficiency and Takeover Bid Regulation" (1986) 24 Osgoode Hall LJ 919.

[31] Wayne H Mikkelson & M Megan Partch, "The Decline of Takeovers and Disciplinary Managerial Turnover" (1997) 44 Financial Economics 205; VA Kennedy & RJ Limmack, "Takeover Activity, CEO Turnover, and the Market for Corporate Control" (1996) 23:2 Journal of Business Finance & Accounting 267; Simon Deakin & Giles Slinger, "Hostile Takeovers, Corporate Law, and the Theory of the Firm" (1997) 24:1 Journal of Law and Society 124; James P Walsh & Rita D Kosnik, "Corporate Raiders and Their Disciplinary Role in the Market for Corporate Control" (1993) 36:4 The Academy of Management Journal 671; Julian Franks & Colin Mayer, "Hostile Takeovers and the Correction of Managerial Failure" (1996) 40 Journal of Financial Economics 163.

[32] Simmonds, *supra* note 22 at 170.

The conflict of the board and management is a key issue and has been addressed in both U.S. and Canadian jurisprudence.[33] It is clear that any new regulation or policy would have to address this issue.

3. "The primary objective of takeover bid legislation is the protection of the bona fide interests of target company shareholders. A secondary objective is to provide regulatory neutrality between the offeror and target management."

As noted earlier, the primary objective of takeover bid legislation as outlined in the Kimber Report is not in dispute, but more importantly it may not be decisive in determining how best to regulate defensive tactics. The secondary objective of neutrality or balance has certainly been lost as a result of the impact of NP 62-202 on the takeover bid regulatory regime, which has (except in rare circumstances) led to the inevitable sale of public companies within 60 days of the commencement of a takeover bid.

4. "Target company shareholders have the right to make the takeover bid decision. As such, target management has no valid reason to (unilaterally) deny them that right. Target management motivation effectively becomes irrelevant."

This is arguably the most contentious and unique principle in NP 62-202, especially as articulated in *Canadian Jorex*[34] and *Icahn Partners LP et al and Lions Gate Entertainment Corp.*[35] which bestows the right to make the takeover bid decision on each individual shareholder. The basis for this proposition must be that shareholders are the owners of the corporation and, as with all private property, freedom of alienation is an essential element of private property ownership. Accordingly, shareholders must be allowed to dispose of their property, regardless of whether the disposition is in connection with the sale of control.[36] There are, however, numerous examples in corporate and securities laws where this is simply not true.[37] Moreover, directors in the exercise of their fiduciary duty may consider

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[33] For Canadian jurisprudence see *Teck*; *Canadian Jorex Ltd, Re* (1992), 15 OSBC 257 [*Jorex*];*CW Shareholdings Inc v WIC Western International Communications Ltd* (1998), 39 OR (3d) 755 [*CW Shareholdings*]; *Maple Leaf Foods Inc v Schneider Corp* (1998), 42 OR (3d) 177 (Ont CA) [*Maple Leaf Foods*]; *Re Pulse Data*, 2007 ABASC 895 [*Pulse Data*]; *Re Neo Material Technologies Inc* (2009), 32 OSCB 6941 [*Neo Material*], online <http://www.osc.gov.on.ca/en/Proceedings_rad_20090511_neo-material.htm>. For US jurisprudence see *Unocal*, *supra* note 16; *Revlon*, *supra* note 17; *Paramount Communications Inc v Time Inc*, 571 A.2d 1140 (1989); *Paramount Communications Inc v QVC Network Inc*, 637 A.2d 34 (1994); *Unitrin Inc v American General Corporation*, 651 A.2d 1361 (1995).

[34] *Jorex*, *supra* note 33.

[35] 2010 BCSECCOM 629 [*Icahn*].

[36] Warren Grover & Mark Nicholson, *Take-Over Bid Defenses: Theory and Practice* [unpublished] (Blakes, Cassels & Graydon).

[37] There are numerous instances in securities and corporate law that cover situations where shareholder approval inflicts negative results for the other shareholders who do not approve it. For example, in certain going private transactions the minority is effectively forced to sell contrary to the concept that shareholders have an individual right of ownership. In securities law, majority rather than unanimous shareholder approval is generally required for various transactions, including those that could have a negative impact on share price and thus be detrimental to its owners, such as: (i) in a private placement, when the price per security for a particular transaction will be lower than the market price less the

the interests of other stakeholders and it is arguable that a shareholder in a public company is merely an investor and not a true owner of private property.

This principle, especially as articulated in *Icahn,* conflicts with NP 62-202 itself, which provides that "shareholder approval of corporate action would, in appropriate circumstances, allay"[38] concerns that actions of a board are abusive of the capital markets. Therefore, the individual rights of a shareholder to accept or reject a bid may be trumped by the rights of a majority of the shareholders. Notwithstanding the paternalistic approach of NP 62-202, even then Chairman Beck acknowledged that shareholder approval could "negate a finding of management abuse" and that is why "unilaterally" was inserted in parenthesis in the maxim above. [39]

We would more strongly argue that it would only be in extenuating and unusual circumstances that a transaction which is approved by an informed majority vote of shareholders could be prejudicial to the public interest.

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allowable discount (TSX Company Manual s. 607(e) and s. 608); and (ii) in reverse takeovers (where the transaction is an arm's-length transaction) (TSXV Corporate Finance Manual, Policy 5.2, s. 4). In corporate law: (i) the shareholders of each amalgamating corporation in a long form amalgamation must approve the transaction by special resolution (two-thirds majority) (s. 176(4) OBCA; s. 183(5) CBCA) (though shareholders opposed are entitled to exercise dissent rights to be paid the fair value of their shares by the corporation); (ii) an arrangement under the OBCA, which includes, among other things, an amalgamation, a transfer of all or substantially all property of a corporation, and going private and squeeze out transactions, requires approval by special resolution to proceed with the transaction (s. 182 OBCA)); (iii) when a corporation proposes to sell, lease, or exchange all or substantially all of its property, other than in the ordinary course of business, the sale must be approved by special resolution of the corporation's shareholders (s. 184 OBCA; s. 189 CBCA) (again, dissenting shareholders are entitled to be paid the fair value of their shares by the corporation); and (iv) within 120 days of a takeover bid, if at least 90% of the shares of a public corporation were tendered to the bidder, then the bidder is permitted to acquire the remaining shares whether or not the remaining shareholders agree to sell those shares (s. 188(1) OBCA; s. 206(2) CBCA) (however the CBCA and OBCA also provide a right for minority shareholders to force a bidder to acquire their shares after the bid).

[38] OSC, NP 38, s 3.

[39] Beck, *supra* note 19 at 130, 135, 136 ("In sum, then, National Policy 38 maintains that target shareholders have the right to make the takeover bid decision. Target management conduct that infringes on this right is improper, regardless of good intention, and may invoke a regulatory response. The only caveat to add is that, in certain cases, shareholders may be able to give management that right, and hence Maxim 4 has been qualified with the term "unilaterally". The term calls into the debate the issue of shareholder approval, and whether it may legitimate target management intrusion into the process.

… shareholder approval may legitimize target management's defensive tactics, and regulators should not too readily intervene for the sake of protecting shareholders when they have approved management conduct. Indeed, some commentators have argued that a shareholder approval requirement is a possible solution to the defensive tactics problem[1]. The *City Code* states that action may be taken by the target board which could frustrate a bid or even a shareholder opportunity to make a tender decision, if such action is approved by the shareholders.[2]

It is recognized that in many cases shareholder approval could negate a finding of management abuse, but the argument has its limitations. Shareholders often cannot protect themselves through the use of the voting process, even against tactics that reduce shareholder welfare[3]. Shareholders are seen not as irrational or stupid, but as rationally apathetic. The real costs of either creating opposition to management or even educating the firm's "unsophisticated" shareholders, outweigh the potential costs of the approved tactics. In some cases, even institutional investors may offer only token resistance to management proposals that may be put to a shareholder vote, such as shark repellant amendments[4]. To reflect these realities, it is proper that shareholder approval not automatically allay regulatory concerns about defensive tactics, though it would generally make regulatory intervention less likely").

5. "The appropriate regulatory approach to takeover bids is to encourage unrestricted auctions."

The CSA, in favouring short term value realization, also note that they are of the view that "unrestricted auctions produce the most desirable results in take-over bids".[40] In responding to the one comment letter it received in response to the replacement of NP 38 with NP 62-202, in June 1997, the CSA confirmed that the aforementioned statement regarding unrestricted auctions and its statement that securities administrators will take appropriate action upon becoming aware of defensive tactics which would result in depriving shareholders of the ability to respond to a takeover bid were consistent with its "mandate of protecting the integrity and promoting the efficiency of the Canadian capital markets in the context of take-over bids".[41] Although the latter proposition may be supportable, we would suggest that empirical evidence for the former proposition is wanting if considered over the long term.

6. "It is inappropriate to design a specific set of rules regulating target director conduct, other than those imposed by corporate law fiduciary standards. However, even without specific rules, it is possible to develop presumptions as to what may be proper or improper."

This proposition is generally not contentious, especially if the CSA wishes to regulate all defensive tactics.

In reviewing the guiding principles underlying NP 62-202, we are left with three undisputed principles: (i) target insiders are in a conflict situation when faced with a hostile bid, (ii) the primary objective of take-over bid legislation as articulated in the Kimber Report has not changed and (iii) it is inappropriate to design a specific set of rules regulating target director conduct. What is also clear is that the CSA was (and remains[42]) of the view that shareholders of a target company must ultimately be able to determine if they will accept or reject a bid.

In considering these guiding principles in respect of decisions rendered under NP 62-202 in connection with rights plans, it is clear that maxim 4 was the most important – in that since each

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[40] *Ibid* at 130. The value to be gained through an auction is subject to some debate: "Theoretical literature on auctions implies that bidder asymmetry can be an extremely important factor that affects creation of value and distribution of substantial revenues in the multi-trillion market for takeovers." See Alexander Gorbenko & Andrey Malenko, "Strategic and Financial Bidders in Takeover Auctions" (September 2010) at 1 online: <http://www.business.uconn.edu/finance/seminars/papers/StratFin.pdf>. Gorbenko and Malenko also note that "[a] premium paid by an acquirer is not just the payment of the bidder with the highest valuation in each auction, but also depends on the number of other potential strategic and financial acquirers and their valuations, which are usually unobserved by researchers" at 1-2.

[41] Ontario Securities Commission, "Notice of National Policy 62-202 and Rescission of National Policy Statement No. 38 Take-Over Bids – Defensive Tactics – Response of the CSA" (August 1997) online: The Ontario Securities Commission <http://www.osc.gov.on.ca/en/13274.htm>.

[42] Canadian Securities Administrators, *Proposed Companion Policy 62-105CP Security Holder Rights Plans*, (2013) 36 OSCB 2643 at 2667 (14 March 2013, Part 3 – Intervention by Securities Regulators, s 6).

shareholder has the right to decide whether to accept or reject a bid the question is generally not if a rights plan should be cease traded, but when should it be cease traded.

We will not review the leading cases under NP 62-202 here, but it is clear that they have provided inconsistent and unsatisfactory results in several circumstances. For example, there remains an irreconcilable gap in regulators' decisions in cases where shareholder approval of a shareholder rights plan has been obtained in the face of a specific bid. Essentially, two poles have emerged:

1. the position 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 (represented by the majority decision of the British Columbia Securities Commission ("**BCSC**") in *Icahn*); and

2. a more nuanced and fact-specific approach that recognizes that rights plans may be adopted for broader longer-term purposes when approved by an "overwhelming" majority of shareholders in the face of a specific bid (represented by the decisions of the OSC in *Neo Material Technologies Inc., Re*[43], the Alberta Securities Commission in *Pulse Data Inc., Re*[44] and the minority reasons of the BCSC in *Icahn*[45]).

It is not clear how the BCSC came to the conclusion that shareholder approval of a rights plan could not in and of itself be evidence that such rights plan is not prejudicial to the public interest. The majority decision in *Icahn* is particularly troubling considering the important theme that shareholder approval played in the draft policies that preceded NP 62-202 and in the provisions of NP 62-202 itself.

Probably even more troubling is the decision of the Bureau de décision et de révision (Québec) (the "**Bureau**") in *Fibrek*.[46] The Bureau blocked an auction that would have provided significant increased value to the shareholders of Fibrek while supposedly upholding NP 62-202.

We believe that the philosophical underpinning of NP 62-202 is flawed and that is the principal reason for conflicting or inexplicable decisions. With the passage of time - and considering the significant differences in the regulatory environment and the power of shareholders since NP 62-202 was adopted - it is difficult to argue that NP 62-202 fosters fair and efficient capital markets and confidence in the capital markets. It is therefore not clear why it should continue to apply in respect of any defensive tactic – even if on a temporary basis.

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[43] *Neo Material*, *supra* note 33.

[44] *Pulse Data*, *supra* note 33.

[45] *Icahn*, *supra*, note 35.

[46] *AbitibiBowater Inc v Fibrek Inc* 2012 QCBDR 13, finalized on March 6, 2012 (2012 QCBDR 17) [*Fibrek*].

Policy concerns regarding defensive tactics

We believe that the fundamental concern relating to defensive tactics is the inherent conflict of interest directors and management face in the context of takeover bids. The Delaware Supreme Court acknowledged in *Unocal* that in the context of a takeover bid there is "the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation or its shareholders."[47] In order to counter this conflict, it would be easy to simply give each shareholder the absolute and unfettered right to accept or reject each bid. While this would solve the conflict issue, it raises significant concerns for the capital markets and the economy as a whole. The results, as noted by many commentators,[48] have been or could be:

- the economy is or could be unduly affected by "arbitrageurs and professional investors whose short term perspectives are not in accordance with the long-term interests of other shareholders and other constituencies of corporations",[49] including employees;[50]
- the creation of a situation which would be tantamount to having a company be perpetually for sale, which could have disruptive effects on its ability to plan and function long-term, which could in turn have implications for the broader economy;[51]
- the "hollowing out" of corporate Canada;[52]
- a less well-regulated market, due to the fact that shareholders are generally subject "to weaker government constraints than corporate managers";[53]
- excessive, duplicated costs borne by shareholders in closely monitoring the company[54] resulting in an inefficient use of resources;
- a market situation in which the sale of a public company subject to a bid would be a foregone conclusion;[55]

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[47] *Unocal*, *supra* note 16 at 954.

[48] See e.g. Martin Lipton, "Takeover Bids in the Target's Boardroom" (1979) 35:1 Business Lawyer 101; Jennifer Hill, "Visions and Revisions of the Shareholder" (2000) 48 Am J Comp L 39; Stephen M Bainbridge, "Director Primacy and Shareholder Disempowerment" (2006) 199 Harv L Rev 1.

[49] Lipton, *supra* note 48 at 104.

[50] Hill, *supra* note 48 at 27.

[51] Lipton, *supra* note 48 at 109-10.

[52] See "'Hollowing out' is hardly a myth", *Toronto Star* (30 January 2008) online: Toronto Star <http://www.thestar.com/opinion/2008/01/30/hollowing_out_is_hardly_a_myth.html>; Harry Arthurs, "The Hollowing Out of Corporate Canada: Implications for Transnational Labour Law, Policy and Practice" (2009) 57 Buff L Rev 781.

[53] *Ibid*.

[54] Bainbridge, *supra* note 48 at 28-29.

[55] Lipton, *supra* note 48 at 109.

- having individual shareholders ill-equipped to engage in and bear the costs of negotiation for themselves, and therefore bidders through coercion may effect results contrary to the best interests of shareholders;[56]

- usurping of the board's superior ability to achieve long-term value that it rationally believes could increase shareholder wealth;[57] and

- boards likely having superior information related to the company's value that the shareholders are not aware of, and if they were, could likely affect their decision whether to tender their shares.[58]

It is therefore necessary to address the conflict issue in a more nuanced way that truly is in the public interest.

Historically, under corporate and securities law, the informed vote of disinterested shareholders has resolved the conflict concern.[59] This is a simple but effective approach and the CSA Proposal follows this approach. This approach is consistent with the various draft policies that preceded NP 62-202; and therefore could also be used for other defensive tactics. It is acknowledged however that for certain defensive tactics[60] – especially those undertaken so as to obtain a higher price from a white knight – this may not be a practical approach. Accordingly, an alternative (but, from a policy perspective, consistent) approach is required for certain defensive tactics. We

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[56] *Ibid*; Marcel Kahan & Edward B Rock, "Corporate Constitutionalism: Antitakeover Charter Provisions As Precommitment" 152 U Pa L Rev 473 at 485-86.

[57]Park Mcguinty, "The Twilight of Fiduciary Duties: On the Need for Shareholder Self-Help in an Age of Formalistic Proceduralism" (1997) 46 Emory LJ 163; Kahan & Rock, *supra* note 56 at 484-86.

[58] Kahan & Rock, *supra* note 56 at 481-83.

[59] For example, MI 61-101 requires issuers to obtain disinterested shareholder approval for business combinations (amalgamation, arrangement, consolidation, transactions where a shareholder's interest may be terminated without their consent, regardless of whether the shares will be replaced with other shares, etc.) and for related party transactions (transactions between an issuer and a related party of the issuer such as a controlling shareholder for asset sales and purchases, for issuing or subscribing shares, for lending or borrowing, etc.) (see Part 4, 5 and 8); The TSX Company Manual also prescribes disinterested shareholder approval for transactions including those that materially affect control of the issuer or provides consideration to insiders in aggregate of 10% or more of the market capitalization of the issuer during any six month period that is not negotiated at arms-length (s. 604); private placements or issuance of warrants at lower prices (below the allowable discount) (ss. 607(e), 608, respectively); and security based compensation arrangements if participation of eligible insiders in all arrangements exceeds 10% of the issued and outstanding shares (s. 613). Under the TSXV Corporate Finance Manual, MI 61-101 is adopted for TSXV issuers (TSXV Policy 5.9), and disinterested shareholder approval is also required for a change of business or reverse takeover (TSXV Policy 5.2). In each of the above instances requiring disinterested shareholder approval, the issuer is also required to provide such shareholders with information sufficient for an informed decision/vote. Under the OBCA and CBCA, ordinary or special resolution approval by shareholders, depending on the transaction, is required for any sale of all or substantially all assets of a corporation (s. 184 OBCA; s. 189 CBCA), going private transactions (equivalent to the definition of business combinations in MI 61-101, s. 190 OBCA; s. 193 CBCA), squeeze out transaction (s. 194 CBCA), long form amalgamation (s. 176 OBCA; s. 183 CBCA) and arrangements (s. 182 OBCA). Similar to securities laws, corporate laws also require disclosure to shareholders of sufficient information for them to knowledgeably decide whether to accept or reject the transaction.

[60] For example, the issuance of shares to attract a white knight as in *Fibrek* or the provision of a significant break fee.

would suggest that as a result of the CSA's focus on shareholder approval being a necessary prerequisite for them to provide boards with supposedly greater flexibility in the context of defensive tactics, the CSA have prevented themselves from finding a solution to the regulation of defensive tactics in general.

Before leaving the issue of shareholder approval, we would note that much has been made in the CSA Proposal (and elsewhere) of the requirement under the *City Code* that all effective defensive tactics undertaken by a board must be approved by the shareholders of the target.[61] We would note, however, that a balance has been struck under the *City Code* in that, with respect to partial bids, a person who seeks to acquire 30% or more of the voting shares of a target must make a bid conditional on approval of the offer (usually signified by means of a separate box on a form of acceptance) being given in respect of over 50% of the voting rights held by shareholders who are independent of the bidder and persons acting in concert with the bidder.[62] With respect to bids that could result in an offeror holding more than 50% of the voting rights, the bid must generally be conditional on the offeror acquiring or agreeing to acquire over 50% of the voting rights.[63]

Another way to address the conflict issue, and impose a rule applicable to all defensive tactics, is to defer to the decision of directors, in light of the significant governance rules imposed on them and the well articulated fiduciary standards to which they are now subject, if they take appropriate steps to address conflicts. We note, however, that the protection of investors and fostering fair and efficient markets and confidence in the markets are the underlying principles that securities regulatory authorities consider in connection with the exercise of their public interest discretion and power to cease trade rights plans. The regulators' focus must therefore continue to largely be on the impact that a decision of a board would have on the capital markets or shareholders. Accordingly, while a target board could follow a proper process, and reach a decision consistent with the exercise of its fiduciary duties, such 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. The question one must ask is whether such situations would be so rare that they are best left to the public interest discretionary powers of the CSA. If not, additional criteria may well be required to be enumerated in order for this approach to be effective. However, even in such circumstances, the fiduciary duty and obligations imposed on directors may well assist in framing what is in the public interest. Moreover, if directors were required to undertake a transaction to meet their fiduciary duty, it would be very troubling if that transaction was held to be contrary to the public interest.

Another approach would be, as some commentators have suggested, for securities regulators to exit the picture entirely on defensive tactics, for NP 62-202 to be repealed and for such matters

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[61] *City Code, supra* note 11 at Rule 21.1.

[62] *Ibid* at Rule 36.5.

[63] *Ibid* at Rule 10.

be left to the courts to decide.[64] We do not believe that a decision of securities regulators to not exercise their public interest discretion in respect of defensive tactics is a realistic prospect. The regulators' jurisdiction to intervene on public interest grounds has longstanding authority, and courts afford a high degree of deference to the decisions of securities regulators. More importantly, as noted above, the power to intervene on public interest grounds may lead to different results than would be decided by a court in examining the fiduciary duty standard.

A Possible Third Approach

Key Policy Maxims

In light of the foregoing, we would (in using the format of the former Chairman of the OSC[65]) summarize the regulatory philosophy which we believe should be embodied in the regulation of defensive tactics in the following maxims:

- Directors, and particularly management, are in a conflict of interest situation when facing a hostile bid. We believe that this principle is beyond dispute.

- The primary objective of the regulation of defensive tactics is the protection of the *bona fide* interests of target company shareholders, which interests may be satisfied by the directors taking steps which are in the long-term interests of the target. We believe it is inappropriate for the CSA to conclude that unrestricted auctions are always desirable. This approach ignores the role and duties of directors and is a clear and unwarranted vote in favour of maximization of value over the short term.

- Unlike most change of control transactions for public companies, takeover bids are made directly to shareholders of a target and, as the owners of the target, there is a presumption that it is in the public interest that shareholders should ultimately have the right to make the decision to accept or reject the bid. It is best that such shareholder decision be made by a majority of shareholders to avoid coercion. Notwithstanding our concerns with the view that shareholders must be the final arbiters with respect to a decision to accept or reject a bid, we acknowledge that this appears to be the firm position of the CSA. We would argue, however, that if this principle is viewed as a presumption, this may well be the basis of a rule or policy that can be used in connection with all defensive tactics. We also believe that this approach can only be used if shareholder approval is expressed through a majority vote and not based on an individual decision of each shareholder.

- Directors of target companies are subject to significant legal and practical governance restraints and are obligated to act in the best interests of the target – not just its shareholders – and it is in the public interest to not subject directors to liability or conflicting duties in circumstances where they have met their fiduciary duty obligations.

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[64] Edward Waitzer & Sean Vanderpol, "Let Courts Rule On Poison Pills", *National Post* (25 January 2011) online: National Post <http://fullcomment.nationalpost.com/2011/01/24/fp-comment-let-courts-rule-on-poison-pills/>.

[65] Beck, *supra* note 19 at 121.

Nevertheless, the underlying policies of the takeover bid regime may well impose additional (but not inconsistent) obligations on directors. This principle is consistent with the AMF Proposal and recognizes the significant responsibilities imposed on directors and the critical role they can play to enhance shareholder value both in the short- and the long-term.

- It is in the public interest for these regulations to be clear and definitive in order to ensure that rules are applied consistently across the country and that all market participants know the rules.

Basic Elements of Proposed Policy or Instrument

If these maxims were to be accepted, we would propose that the CSA adopt a national instrument or policy which would have the following basic elements:

1. **It will be presumed that any action taken by a target which has the effect of depriving shareholders, or will likely result in shareholders being deprived, of the ability to accept a takeover bid (such action is referred to herein as a "Regulated Defensive Tactic") will be contrary to the public interest unless approved by a "majority vote" of duly informed shareholders either prior to the commencement of the takeover bid or within 90 days of the date of the commencement of such takeover bid.**

   As noted earlier, from a practical perspective, we accept that it will generally be required for shareholders by majority vote to have the final say as to whether a bid should be accepted. However, if this rule is paramount we believe that it will be difficult to formulate a regime which can effectively regulate all defensive tactics. This is particularly true if any deference is to be given to directors. As a result, we have proposed that there be a rebuttable presumption that if a Regulated Defensive Tactic is adopted by a board, without shareholder approval being obtained within 90 days of a bid, then such action would be prejudicial to the public interest. As a practical matter, we believe that this presumption already exists. In paragraph 3 below, we discuss how this presumption may be rebutted.

   We believe that it is critical for the CSA to take this opportunity to formulate a regulation or policy that applies to all defensive tactics, not just rights plans. The decision in *Fibrek* is simply untenable[66] and there is great risk that without clear direction to commissioners there will be more troubling decisions with respect to the use of other defensive tactics.

   Furthermore, we believe that the CSA Proposal does not effectively "empower" boards. While it provides boards with more time to respond to bids if a rights plan is adopted, the

[66] See our commentary on the *Fibrek* decision by Paul D Davis, Assunta Di Lorenzo & Richard Yehia, "Defensive Tactics – Public Interest Powers of Securities Regulatory Authorities Continue to Evolve – the *Fibrek* Decision" (May 2012), online: McMillan LLP <http://mcmillan.ca/publications>.

CSA Proposal continues with the paternalistic themes, as previously echoed by Chairman Beck[67], which permeate NP 62-202. It is particularly interesting that, under the CSA Proposal, notwithstanding that rights plans have to be approved by shareholders annually (which provisions we would also adopt under our approach) and within 90 days of their adoption, shareholders would have the right to revoke them at any time. Is this "flexibility" being provided to shareholders because they cannot be trusted to make a decision that would impact them for 12 months? The justification given for this proposed rule under the CSA Proposal is that it gives ultimate control to shareholders; and it allows a requisitioned meeting to be called to terminate a rights plan as opposed to remove directors so that the new directors could terminate the plan – the latter being more difficult and the only other option left to shareholders if they wished to remove a rights plan earlier than the next annual shareholders' meeting. This latter distinction is not at all convincing, as requisitioning a meeting for either purpose would be costly. We would also note that this right assumes that a bidder will have a minimum of 5% of the shares of a target (or, for a company governed by the *Business Corporations Act* (Québec), 10%) in order to requisition a meeting of shareholders. With respect to giving ultimate control to shareholders, if shareholders wish to have the right to terminate a rights plan at will, this feature may be included in a rights plan. Clearly shareholders are being empowered under the CSA Proposal – the argument that directors are being empowered is far from convincing.

We believe that the creation of this presumption will provide directors with greater flexibility to act in the best interests of the target corporation and will thereby truly empower directors. No one can doubt that shareholders have significant powers and are becoming more accustomed to exercising such powers. On the other hand, directors, who have been legally entrusted to protect the interests of all stakeholders of a corporation and who have access to more information than shareholders, are being required to remain effectively passive.

2. **Shareholder approval of a Regulated Defensive Tactic as aforesaid will prevent a challenge under the new rule or policy; "majority vote" means the approval of shareholders of the target by ordinary resolution, provided that if the vote is taken in circumstances where a tactical rights plan or other tactical Regulated Defensive Tactic is being approved, the votes held by the following shareholders shall not be considered: (i) directors and senior officers of the target, (ii) the offeror(s) against whom the Regulated Defensive Tactic is directed and its directors and senior officers and (iii) the affiliates, associates and joint actors of each of the foregoing**.

   The CSA Proposal notes that because a vote on a rights plan is a referendum on a bid, the bidder should not vote. We would suggest that the only time a vote on a rights plan or

[67] Beck, *supra* note 19 at 130, 135, 136.

other Regulated Defensive Tactic is truly a referendum on a bid is in respect of a tactical Regulated Defensive Tactic. [68]

We would also note that the conflict faced by directors and management in responding to a hostile bid is beyond dispute. It would therefore be very troubling to allow such insiders to vote in favour of a rights plan or other Regulated Defensive Tactic which they have adopted to defeat a hostile bid – especially in circumstances where the bidder itself cannot vote. To argue that in such circumstances management should vote because their vote is proportional to their economic interest misses the point. The very persons who have decided to fight a bid could actually succeed by voting to "just say no" while the bidder they are opposing could be prohibited from voting.

Outside of a vote to approve a tactical plan or other tactical Regulated Defensive Tactic – e.g. the approval of a rights plan annually – we would not expect that a bidder or management should be excluded. For example, if by chance a bid has been made at the time of the annual vote on a rights plan, it is not clear to us why a bidder's votes should be excluded. We acknowledge that this may provide significant incentives for bidders to launch a bid to coincide with a company's annual meeting; but even in those circumstances we do not see the policy basis for excluding a bidder's vote unless management and director votes are also being excluded.

3. **If shareholder approval is not obtained as outlined in paragraph 1, and the Regulated Defensive Tactic is challenged, then the onus will be on the target to prove that the Regulated Defensive Tactic is not contrary or prejudicial to the public interest. In order to meet this onus, the target would have to prove the following:**

    - **board of the target exercised its actions pursuant to a proper process meant to mitigate its inherent conflict, including the use of a special committee of independent directors that has been given an appropriate mandate;**
    - **board had reasonable grounds for believing that it was in the best interests of the target to implement the Regulated Defensive Tactic and, in connection with a tactical Regulated Defensive Tactic, it was a reasonable response to the takeover bid; and**
    - **in the circumstances, it was not practical or meaningful to obtain shareholder approval of the Regulated Defensive Tactic.**

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[68] We acknowledge that a vote on the termination of a rights plan would also be a referendum on a bid; however, as noted above in paragraph 1 of this section, we would suggest that such a right should not be mandated.

We believe that this rule would create a sufficient balance between deference to a board and the rights of bidders and shareholders. This rule would take into account the fiduciary obligations imposed on boards by adopting key principles from Canadian[69] and U.S.[70] jurisprudence while keeping the focus on the importance of seeking shareholder approval. A board in taking steps to defeat a bid without shareholder approval would have a significant burden to discharge, but in appropriate circumstances the burden could be met. For example, on the facts in *Fibrek*, we would expect that the board of Fibrek would have been able to justify its actions and be able to proceed with the transaction that was cease traded.

4. **Prompt disclosure will be required upon the implementation of a Regulated Defensive Tactic, and we would adopt the CSA Proposal disclosure rules.**

5. **Rights plans would not be regulated in a manner different than other Regulated Defensive Tactics; however we have accepted that shareholder approval of rights plans on an annual basis should be required.**

   As noted above, we do not see the need for, or benefit of allowing for, rights plans to be terminated at any time by the vote of shareholders.

   We also don't see the need for requiring the approval of rights plans within 90 days, as they would not be effective after 90 days from the commencement of a bid without shareholder approval as outlined under paragraph 1 above.

   We also do not see the need for rights plans to automatically be waived for other takeover bids (and certainly not exempt takeover bids) if waived for one takeover bid. If shareholders have accepted and approved the right of directors to waive the application of rights plans for some type of bids and not others, it is not evident why this should be contrary to the public interest.

   Finally, we would accept that a material amendment to a rights plan would be treated, for purposes of this rule, as a new rights plan. This approach is consistent with the CSA Proposal. We would note however that amendments of rights plans are, in our experience, rare.

<u>*Conclusion*</u>

We would humbly suggest that while there is significant justification to the CSA Proposal and the AMF Proposal, each proposal has significant weaknesses. For example, the CSA Proposal

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[69] *Maple Leaf Foods, supra* note 33; *CW Shareholdings*, *supra* note 33 at 769.

[70] See *In re Del Monte Foods Company Shareholders Litigation*, 25 A.3d 813 (2011) (Del Ch); *Unocal*, *supra* note 16; *Unitrin*, *supra* note 33; *Weinberger v UOP Inc*, 457 A.2d 701 (1983) (Del Sup Ct); *In Re Tele-Communications, Inc Shareholders Litigation*, 2005 WL 3642727 (Del Ch); *In re Southern Peru Copper Corporation Shareholder Derivative Litigation*, CA No 961-CS (2011) (Del Ch).

does not empower directors or address all defensive tactics. While the AMF Proposal, in focusing on process rather than results, would not truly address the basis for any regulation in this field – i.e. the public interest. In seeking to address those weaknesses, we have sought to propose an alternative approach that recognizes the importance of allowing shareholders (where practical) to make the final decision as to whether to accept or reject a bid but also allows directors to carry out their statutorily imposed duties for the benefit of a target corporation both in the short- and the long-term. We have also tried to use this unique opportunity to ensure that a rule is proposed that regulates all defensive tactics – not just rights plans.

PART II: SUGGESTED REVISIONS TO THE PROPOSED RULE AND THE PROPOSED POLICY

The following outlines our specific suggested revisions to the Proposal Rule and Proposed Policy.

Proposed Rule

Section 1(1): Definition of "rights plan"

In our view, the reference to "purchase or acquire additional equity or voting securities" appears to be too limiting. For instance, we believe the definition should cover rights plans relating to the issuance of preference shares or debt instruments. Some of the first rights plans issued in the United States provided for the issuance of preference shares or debt securities at a substantial discount to market price/value; such an event would obviously be an effective deterrent to a take-over bid.[71] We suggest deleting the words "equity or voting" in the definition; and we would also suggest inserting the words "or market value" after "market price" in the definition.

Section 1(1): Definition of "security holder approval"

As noted in paragraph 2 under *"A Possible Third Approach – Basic Elements of Proposed Policy or Instrument"* in Part I above, we would suggest that the only time a vote on a rights plan is truly a referendum on a bid is in respect of a tactical rights plan; and it is only in such circumstances that an offeror in respect of a bid and its joint actors should be prevented from approving a bid. In such circumstances, we also believe that the votes of directors and senior officers of the issuer and their joint actors should be excluded. The conflict faced by directors and management in responding to a hostile bid is beyond dispute. It would therefore be very troubling to allow such insiders to vote in favour of a rights plan which they have adopted to defeat a hostile bid. To argue that in such circumstances management should vote because their vote is proportional to their economic interest misses the point. The very persons who have decided to oppose a bid could actually succeed by voting to "just say no" while the offeror they are opposing would not be able to have its votes count. We would therefore suggest that the concluding words of this definition (being ", excluding votes cast at the meeting by an offeror in respect of the issuer") be deleted and replaced with the following:

> provided that if the approval is being sought in respect of a rights plan adopted after one or more take-over bids were announced, the votes held by the following shareholders of the issuer shall not be considered: (i) directors and senior officers of the issuer and any persons acting jointly or

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[71] See, for example, *Revlon*, *supra* note 17, where the target board adopted, on August 19, 1985, a "Note Purchase Rights Plan" under which each shareholder would receive as a dividend one note purchase right for each share of common stock, which right would entitle the holder to exchange one common share for a note with a principal amount that was significantly greater than the bidder's offer price. The rights would be triggered whenever anyone acquired beneficial ownership of more than 20% of the target's shares, unless the purchaser acquired all of the target's stock for cash at an amount that was equal or greater than the principal amount of the note.

in concert with any of the foregoing and (ii) the offeror(s) of all such take-over bids and their respective directors and senior officers.

Section 2(2), 2(3) and 2(4): Annual Approval of Rights Plans

After initial security holder approval of a rights plan, Section 2(2) requires security holder approval at the issuer's annual meeting held in each financial year of the issuer that is after the financial year in which the issuer first obtained security holder approval.

Under the proposal, a shareholder-approved rights plan survives until the following year's annual general meeting ("**AGM**"). If not approved at that AGM, the rights plan falls away (with the AGM being the "relevant non-approval date"). But what if the issuer fails to hold the AGM? Section 7(2)(b) refers you back to Section 2(2), but 2(2) does not specify when the AGM must be held. Perhaps it would be clearer if language was added to the effect that annual shareholder approval must be obtained by an issuer no later than the date it is required to hold its AGM pursuant to the applicable corporate statute and the rules of the Toronto Stock Exchange.[72] As a result, we believe revisions will be required to be made to Sections 2(2), 2(3), 2(4) and 10(2).

We would propose, for simplicity, that a defined term be included in Section 1(1) and that it read as follows:

> "Annual Shareholder Approval Date" means the earlier of (i) the date an issuer is required by its governing corporate legislation to hold an annual meeting of shareholders and (ii) one hundred and eighty days following the end of the issuer's most recent fiscal year;

With respect to Sections 2(2), 2(3) and 2(4), we would propose that such provisions read as follows:

> (2) Despite an issuer having obtained security holder approval of a rights plan, or a material amendment to a rights plan, as specified in subsection (1), the issuer must not, following ~~the~~ each issuer's annual meeting of security holders held ~~in each financial year of the issuer that is after the financial year in which the issuer first obtained security holder approval of the rights plan~~ no later than the Annual Shareholder Approval Date in respect of each such meeting, distribute a security pursuant to the exercise of a right issued under the rights plan unless the issuer has obtained security holder approval of the rights plan, including any material amendment, at that annual meeting of security holders.

[72] Reference is not made to the policies of the TSX Venture Exchange Inc. due to the fact that Policy 3.2 thereof defers to the corporate and securities laws applicable to the timing of AGMs. It may be argued that it is not appropriate to impose rules applicable to Toronto Stock Exchange issuers on venture issuers, however, we believe that to prevent abuse an absolute deadline is required and 6 months following a fiscal year-end is believed to be reasonable.

(3) If, pursuant to section 5, an issuer is not subject to paragraph (1)(a), the issuer must not, following ~~the~~ each issuer's annual meeting of security holders ~~held in each financial year of the issuer that is after the financial year during which~~ following such time that the issuer first became a reporting issuer in any jurisdiction of Canada held no later than the Annual Shareholder Approval Date in respect of each such meeting, distribute a security pursuant to the exercise of a right issued under the rights plan unless the issuer has obtained security holder approval of the rights plan, including any material amendment, at such annual meeting of security holders.

(4) Despite subsection (1), an issuer may distribute a security pursuant to the exercise of a right distributed under a rights plan of the issuer during the period commencing on the date of adoption of the rights plan or a material amendment to the rights plan and ending on the ~~earlier~~ earliest of

(a) the date of the meeting of security holders during which the issuer sought, but failed to obtain, security holder approval of the rights plan or the material amendment to the rights plan, ~~and~~

(b) an Annual Shareholder Approval Date, if by such date security holder approval of the rights plan or the material amendment to the rights plan has not been obtained, and

(c) the date when security holder approval of the rights plan or the material amendment to the rights plan is required under subsection (1).

We would propose that Section 10(2) be revised to provide as follows:

(2) If an issuer adopted a rights plan on or before **[effective date]**, the issuer must not, following the earlier of:

(a) the date of the issuer's next annual meeting held 90 days or more after **[effective date]**, and

(b) the Annual Shareholder Approval Date that is 90 days or more after **[effective date]**,

distribute a security pursuant to the exercise of a right issued under the rights plan unless the issuer obtains or has obtained security holder approval of the rights plan, including any material amendment, at such annual meeting.

Section 2(5): Right of shareholders to terminate rights plan

As discussed under paragraph 2 under *"A Possible Third Approach – Basic Elements of Proposed Policy or Instrument"* in Part I, it is not clear to us why a right to terminate a rights plan at any time should be mandated. The justifications given for this proposed rule under the CSA Proposal is that it gives ultimate control to shareholders; and it allows a requisitioned meeting to be called to terminate a rights plan as opposed to remove directors so that the new directors could terminate the plan – the latter being more difficult and the only other option left to shareholders if they wished to remove a rights plan earlier than the next annual shareholders' meeting. This latter distinction is not at all convincing, as requisitioning a meeting for either purpose would be costly. We would also note that this right assumes that a bidder will have a minimum of 5% of the shares of a target (or, for a company governed by the *Business Corporations Act* (Québec), 10%) in order to requisition a meeting of shareholders. With respect to giving ultimate control to shareholders, if shareholders wish to have the right to terminate a rights plan at will, this feature may be included in a rights plan. The mandatory inclusion of this right for the benefit of shareholders suggests that the CSA believes that shareholders require not only protection from boards, but themselves. Having approved a rights plan and having the right to terminate the plan at the next annual meeting, why do shareholders need the right to terminate the plan at will?

We would therefore recommend the deletion of Sections 2(5) and 7(3), as well as the deletion of the words "and may terminate a rights plan," in Section 2(6)(a)(vii).

Section 2(6)(v) and Section 2(7): Independent Directors

In the required press release disclosure, Section 2(6)(v) refers to review by independent directors. Section 2(7) outlines circumstances in which a director would not be independent. We believe that Section 2(7) provides a low threshold of independence which is not consistent with current practice with respect to the composition of a special committee that considers the adoption of a rights plan, and certainly not consistent with the current practice with respect to considering the adoption of a tactical rights plan. We would suggest that the CSA consider the independence standards from Section 1.4 or Sections 1.4 and 1.5 of National Instrument 52-110.

Section 3: Scope of Rights Plan

In our experience, a rights plan can be triggered for reasons other than a take-over bid or the acquisition of securities. Through expansive definitions of beneficial ownership (for example, using derivatives in calculating beneficial ownership and having a broader definition of deemed beneficial ownership than under securities legislation), it may be possible to trigger a rights plan by acting in concert with a party who is deemed to own shares under such an expansive definition. In such circumstances, there would be no take-over bid and no acquisition of securities, but the rights plan would be triggered. Rights plans may also be structured so as to be triggered by the entering into of lock-up agreements. We are not aware of any public policy or public interest concerns with allowing issuers and their shareholders to design rights plans which address these issues. We would agree, however, with the principal thrust of this provision: rights plans should not be allowed to impact on the rights of shareholders to elect directors. While there is a dearth of Canadian jurisprudence on this matter, the decision of the Court of Chancery of Delaware in *Yucaipa American Alliance Fund II L.P.* et al. v. *Barnes & Noble, Inc.*

et al. 1 A.3d 310 supports this proposition[73]. We would suggest that Section 3 be revised to limit its application to the public interest concern it is seeking to address and to codify the common law:

> An issuer must not distribute a security pursuant to the exercise of a right issued under a rights plan as a result of the solicitation of proxies or any step taken, directly or indirectly, to nominate or elect directors of an issuer.

Section 4: Waiver of rights plan

From a policy and philosophical perspective, we would suggest that those with ultimate control – i.e. shareholders – should have the right to determine the provisions of rights plans without interference from regulators unless the interference of the regulator is for the purpose of codifying the common law. As a result, we would recommend that this provision be deleted notwithstanding we understand why some may consider it necessary. At the very least, we would strongly recommend that the provision be revised.

Typically, rights plans in Canada permit the board of an issuer to waive application of a rights plan to a formal take-over bid without shareholder approval and such waiver is usually deemed to be a waiver in respect of all other formal take-over bids. It is not clear why the CSA should seek to extend waivers of rights plans to exempt take-over bids. We would suggest, at the very least, that Section 4 be amended to make it clear that the provision applies only to formal take-

[73] The Court in referring to the seminal decision in *Moran* v. *Household Int'l Inc.* 490 A.2d 1059 stated as follows:

> "The fact is that the effect of a pill with a 20% trigger on the ability of insurgents to wage a joint proxy contest was a central issue in *Moran*. In that case, the plaintiff Moran's 'first claim allege[d] that, [through the pill], a majority of Household's directors manipulated the corporate machinery to entrench themselves in office by restricting the shareholders' right to make use of the proxy machinery to gain control of Household.' And, in that case, the pill was triggered if a 'person … announce[d] the formation of a group of persons holding 20% to act together.' Indeed, the court explicitly noted that a 'troublesome aspect of the Rights Plan is its potential restriction on proxy contests. The proxy inhibition arises because one of the events which trigger issuance of the preferred is the formation of a group representing 20% of Household stock for the purpose of conducting a proxy contest.'
>
> In upholding the Household rights plan, the court founded that although this restriction 'deter[red] the formation of proxy efforts of a certain magnitude, it [did] not limit the voting power of individual shares.' Likewise, it settled a question that is raised here. The Household rights plan did not prohibit a holder of 20% from merely soliciting and receiving revocable proxies during a proxy contest. A 20% holder (or group less than 20%) was free to propose a slate on its own, run a proxy contest, and solicit revocable proxies. What it could not do was to reach agreements with a group of holders owning over 20% to join together, form an agreed upon slate, and jointly fund and conduct a proxy contest. Indeed, *Moran* dealt directly with the reason for that limitation. To wit, the court expressly recognized that the Rights Plan could not prevent a bidder from amassing sufficient voting power so as to vitiate the purpose of the pill in protecting the corporation's stockholders from an acquisition at an inadequate price or through coercion without covering concerted electoral action. Accepting that premise, the court found that the application of the 20% trigger to joint action to propose a proxy contest was reasonable. Its ultimate finding was buttressed by the evidence that a single stockholder or group of stockholders owning up to the 20% limit could still wage a winnable proxy contest."

over bids and not exempt bids. This could be easily achieved by inserting "formal" before the word "take-over" wherever it occurs in such provision.

Proposed Policy

Paragraph 3: Material Amendments

We believe it would be helpful if the Proposed Policy included examples of amendments that would be considered by Canadian securities regulators to constitute material amendments.

PART III: RESPONSE TO CSA REQUEST FOR COMMENTS

Our responses to the specific questions posed by the CSA in their request for comments are set out below. We do not have any comments on questions 6, 15 and 16 and, as such, have omitted these three questions from the responses below.

General

1. **In your view, is the Proposed Rule preferable to the status quo, amending the bid regime to mandate "permitted bid" conditions and disallow Rights Plans, or amending NP 62-202 to provide specific guidance on when securities regulatory authorities would intervene on public interest grounds to cease trade a Rights Plan?**

We agree that the current regulatory approach to rights plans is no longer appropriate. The legal and regulatory environment within which NP 62-202 and its predecessor were adopted was fundamentally different than the current environment. Currently, shareholders have significantly more tools available to them to protect their interests, directors duties' have been better defined and improved standards respecting corporate governance practices and the disclosure thereof have been recognized and, for the most part, implemented. The current regulatory approach has resulted in inconsistent decisions as between securities regulatory authorities and in some instances, by different panels within a single securities regulator. The resultant uncertainty created among market participants does not serve to foster fair and efficient capital markets or confidence in the capital markets. Accordingly, the status quo is not preferable.

In our view, mandating "permitted bid" conditions while disallowing rights plans is not an appropriate regulatory response. While the "permitted bid" conditions would address the concern over the perceived structural coerciveness of takeover bids, this would not serve the public interest if at the same time rights plans were disallowed. This would not extend shareholder suffrage and would continue the existing trend of limiting the role of directors of a target company to that of auctioneers in what is almost inevitably, the sale of the target company in the near term. As is the weakness in the current system, one size does not fit all. We would suggest that a hybrid of the Proposed Rule of the CSA and the AMF Proposal, as we have outlined in Part I of our response, under "*Basic Elements of Proposed Policy or Instrument*" is the preferable approach.

We also believe that the CSA's focus initially on rights plans is too narrow and believe that it is important that all defensive tactics be addressed.

2. Do you think that implementing the Proposed Rule will reduce the need for securities regulators to review Rights Plans through public interest hearings? Please provide details.

Implementing the Proposed Rule would lessen the need for regulators to review rights plans through public interest hearings. Under the current regime, hearings are mandated by the need to determine 'when a plan should go' and are the only mechanism to enforce what has generally become (prior to the decisions in *Neo* and *Pulse Data*) a predetermined outcome to cease trade rights plan within less than 60 days following commencement of the bid. The Proposed Rule mandates shareholder approval of rights plans, a factual determination which should not require regulatory review.

3. Do you think the Proposed Rule will have any negative impact on the structure of take-over bids in Canada? Please provide details.

The Proposed Rule will increase the time necessary to complete a bid from the current minimum 60 days (for target companies with rights plans in place or which adopt tactical plans) to a minimum of 90 days. The Proposed Rule should also result in more negotiated bids, rather than unsolicited bids. We do not consider either of these outcomes as negative developments.

Potential bidders will also need to consider the time and expense of requisitioning a shareholders' meeting of the target. There may be an advantage to launching a bid shortly before a target's AGM at which a rights plan is to be considered. This strategy would avoid the expense of requisitioning a meeting to either terminate the rights plan (as contemplated in the Proposed Rule) or to replace the members of the Board of Directors of the target with nominees amenable to removing the rights plan. Launching a bid prior to an AGM would also avoid the need for the potential bidder to take a significant toehold position in the target, a position large enough to enable it to requisition a shareholders' meeting (5% ownership, or in the case of target companies governed by the *Business Corporations Act* (Québec), 10%). The concern of a potential bidder to not inadvertently disclose its plans to the target by acquiring such a significant toehold will be heightened if the proposed amendments to Multilateral Instrument 62-104, to lower the early warning reporting threshold from 10% to 5% ownership, are ultimately adopted. As a result, the requisitioning of a shareholders' meeting may become an obligation to be borne by those shareholders who agree to lock-ups.

4. Is the discretion given to a board of directors under the Proposed Rule appropriate?

As we noted in Part I, the Proposed Rule does not truly empower boards of directors. Any additional discretion created by the Proposed Rule will be limited to allowing directors to determine whether or not a rights plan should be presented to shareholders for approval. Even if directors exercise their discretion to present a rights plan to

shareholders as being in the target's best interests, the Proposed Rule would allow this exercise of discretion to be challenged and overturned at any time, notwithstanding prior shareholder approval of the rights plan.

We believe that a level of discretion placed in the hands of a board of directors is appropriate. This discretion should be broader than deciding whether or not to implement a rights plan. It should allow a board of directors to consider the response, including the selection of one or more Regulated Defensive Tactics, most appropriate in the circumstances. Given the inherent conflict faced by a target's board of directors, such discretion should not be unlimited. Shareholders as a collective must be provided with an opportunity to confirm the exercise of such discretion by majority vote. Only in exceptional (and we expect limited) circumstances would a board of directors be permitted to proceed without shareholder approval and then only if it can establish scrupulous adherence to process (through the use of an independent special committee of directors, having an appropriate mandate) and establish that the board's response was both reasoned and reasonable in the circumstances.

5. **In your view, would the increased leverage of target boards and greater shareholder control over the use of Rights Plans that would result under the Proposed Rule unduly discourage the making of hostile take-over bids? If you believe hostile take-over bids will be inhibited, please explain whether or not you support that impact or have concerns. If you believe that the Proposed Rule may unduly discourage hostile take-over bids, please explain how you would modify the Rule to address your concerns.**

Unsolicited bids will take more time to complete under the Proposed Rule, given the 90-day limit to obtain shareholder approval of a rights plan. We believe that the Proposed Rule will also result in more frequent and more extensive negotiations between the bidder and the target prior to a bid being commenced and during the term of the bid, which may further extend the time and possibly the expense necessary to complete a bid. We do not believe these changes will impose serious impediments to the making of unsolicited bids.

<u>**Specific**</u>

7. **The Proposed Rule contemplates that Rights Plans are effective following adoption provided that they are approved by shareholders within 90 days.**

    (a) **Is this timing appropriate? Should issuers have more or less than 90 days to obtain shareholder approval of a Rights Plan?**

    Ninety days to obtain shareholder approval is an appropriate time limit. This will allow the target's board of directors to appropriately review and consider an unsolicited bid and to review available alternatives, before having to make a decision on whether to implement a Regulated Defensive Tactic and to call a shareholders' meeting to present same to shareholders for approval. Given the time necessary to call and hold a shareholders' meeting, reducing the ninety-day

period by any meaningful amount would have the effect of forcing the board of directors of the target to immediately call and begin to prepare for a shareholders meeting upon notification of a takeover bid, in case that adoption of a rights plan turned out to be appropriate in the circumstances, without having had sufficient time to consider the merits of the proposed transaction or an appropriate response thereto.

(b) Should the time period for shareholder approval be different depending on whether the Rights Plan was adopted in the absence of a proposed take-over bid or adopted in the face of a take-over bid?

We support the Proposed Rule's requirement that a rights plan be approved annually by shareholders and, if adopted in the face of a bid, within 90 days following commencement of a bid. We do not support that a rights plan must in all circumstances be approved within 90 days. See paragraph 5 under "Part I – A Possible Third Approach – *Basic Elements of Proposed Policy or Instrument*".

8. The Proposed Rule contemplates that a Rights Plan that is adopted after a take-over bid is made may remain in effect for a 90 day period pending security holder approval. We note that this 90 day period is longer than both the minimum 35 day period that a bid is required to be outstanding under applicable securities legislation and the 45 to 55 day period by which securities regulators have historically ceased traded a Rights Plan when successfully opposed by a bidder. Please provide your comments on the effect of this extension of the time.

We support the ninety-day period during which a newly adopted or amended rights plan may remain in place following commencement of a bid and pending shareholder ratification. As noted in our response in 7(a) above, given the time necessary to call and hold a shareholders' meeting, a significant reduction in the 90-day time frame could unduly impinge on the board of directors' and on the shareholders' abilities to carefully consider the proposed transaction and to consider possible alternatives thereto.

9. While the Proposed Rule contemplates that Rights Plans are effective following adoption provided that they are approved by shareholders within the specified 90 day period, it does not mandate that a shareholder meeting be held within this 90 day period. This means, in effect, that a Rights Plan can remain in place for 90 days even if the board of directors choose not to hold a meeting. Should the Proposed Rule address the circumstance where an issuer does not take steps to call a shareholder meeting after a Rights Plan has been adopted?

Mandating that a shareholders' meeting must be called well in advance of the expiry of the 90 day period (or failing which the 90 day period would be extinguished) would have the undesirable effect of shareholders' meetings being called immediately upon notification of an unsolicited bid, "just in case" one is needed, without the target's board having had sufficient opportunity to consider the proposed transaction and the appropriate response thereto.

10. The Proposed Rule contemplates that all Rights Plans must be re-approved by shareholders by no later than the date of the issuer's annual meeting in each financial after the issuer first obtained security holder approval.

(a) Is this timing appropriate?

While we could advocate for a longer period of time for reapproval, from a policy perspective we accept that rights plans should be reapproved at the issuer's annual meeting.

(b) Should Rights Plans that were adopted in the absence of a proposed take-over bid be effective for a longer period of time than Rights Plans that were adopted in the face of a take-over bid?

Rights plans that were adopted in the absence of a takeover bid should be effective until the first to occur of the issuer's next annual meeting of shareholders and 90 days following commencement of a takeover bid for the issuer's securities.

11. The definition of "security holder approval" in the Proposed Rule does not exclude votes cast by management of the issuer. Please explain whether or not you believe this is appropriate. Does your answer depend on whether the security holder approval is being sought in respect of a Rights Plan that was adopted in the absence of a proposed take-over bid as compared to one that was adopted in the face of a take-over bid? Would you like to see any other any other voting issues addressed?

Officers and directors of the issuer should be permitted to vote on rights plans being adopted in the absence of a proposed takeover bid. Due to the inherent conflicts faced by members of management and the board of directors of an issuer faced with a proposed takeover bid, officers and directors of the target issuer should not be permitted to vote on a rights plan being adopted following commencement of a bid. Please see our suggested changes to this definition in Part II.

12. Section 3 of the Proposed Rule limits the effectiveness of rights plans to take-over bids and the acquisition of securities of an issuer by any person. Does this limitation unduly restrict the potential applications of rights plans? Should rights plans be permitted to be effective against irrevocable lock-up agreements?

The Proposed Rule should not regulate or restrict the content of rights plans, unless clearly required from a public interest perspective. See our comments under "Part II – Proposed Rule – *Section 3: Scope of Rights Plan*". Rights plans should not be permitted to regulate the calling of shareholders' meetings or the solicitation of proxies by dissident shareholders.

13. Do you agree with the application of the Proposed Rule to material amendments to a Rights Plan? Do you believe that the nature of what may constitute a material

amendment should be more fully addressed in the Proposed Rule or the Proposed Policy?

We agree that the approval of shareholders to material amendments to rights plans should be mandated by the Proposed Rule. The Proposed Policy should include a description of the nature of amendments likely to be considered material by securities regulators, but should also provide securities regulators with flexibility to consider whether other amendments may be material in the circumstances.

14. Should the Proposed Rule or Proposed Policy facilitate the ability of dissident shareholders or a bidder to challenge a pre-approved rights plan beyond the provisions of applicable corporate law by, for example, setting a minimum time period within which a meeting must be held or by dispensing with minimum ownership requirements?

We do not believe that the Proposed Rule should facilitate the ability of dissident shareholders or bidders to challenge a pre-approved Rights Plan. We believe shareholders should be provided with the authority to make a decision that will impact them for the longer term (that is, whether to support management's adoption of a rights plan that will be in effect until the next annual meeting of shareholders) without that decision being required to be reopened at any time. Shareholders sufficiently concerned about the length of time that a shareholder-approved rights plan may be effective could require that management present to shareholders a rights plan that will allow the approval of the rights plan to be reconsidered by shareholders within a shorter time period or in specified appropriate circumstances.

PART IV: RESPONSE TO AMF REQUEST FOR COMMENTS

Our responses to the specific questions posed by the AMF in the AMF Proposal are set out below. We do not have any comments on question 9 and, as such, have omitted this question from the responses below.

1. If proper safeguard measures to manage conflicts of interest are put in place and there exists no circumstance that demonstrates an abuse of security holders' rights or a negative impact of the efficiency of capital markets, do you agree that Regulators should give appropriate deference to the decision of target boards to implement a defensive measure?

In theory, we would agree. We would note, however, that if there exists no abuse of security holders' rights and there is no negative impact on the efficiency of the capital markets, then Canadian securities regulators should have no concerns with the actions of a target. The question highlights our principal concern with the AMF Proposal as set out below.

As noted above, the protection of investors and fostering fair and efficient markets and confidence in the markets are the underlying principles that securities regulatory

authorities consider in connection with the exercise of their public interest discretion and power to cease trade rights plans. The regulators' focus must therefore continue to largely be on the impact that a decision of a board would have on the capital markets or shareholders. Accordingly, while a target board could follow a proper process, and reach a decision consistent with the exercise of its fiduciary duties, such 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. The question one must ask is whether such situations would be so rare that they are best left to the public interest discretionary powers of the CSA. If not, additional criteria may well be required to be enumerated in order for this approach to be effective. However, we would suggest that, even in such circumstances, the fiduciary duty and obligations imposed on directors may well assist in framing what is in the public interest. Moreover, if directors were required to undertake a transaction to meet their fiduciary duty, it would be very troubling if that transaction was held to be contrary to the public interest. Please see "A Possible Third Approach" under Part I above.

2. Do you think giving appropriate deference to directors in the exercise of their fiduciary duty will negatively impact the ability of target security holders to tender their securities to an unsolicited take-over bid?

We agree that directors, in the exercise of their fiduciary duty, should be afforded appropriate deference to respond to an unsolicited take-over bid. Directors are better positioned than shareholders to act in the best interests of the target – both in the short- and the long-term interest of the target. There can be no doubt however that the actions of directors in such circumstances could negatively impact the ability of shareholders to respond to a take-over bid. The interests of shareholders and directors are not always aligned; however, that is why shareholders have the ultimate power to determine who the directors are from time to time. We believe that our proposal in Part I (see "A Possible Third Approach") strikes an appropriate balance between showing deference to directors and allowing shareholders to decide whether to accept or reject a take-over bid.

3. Should directors, in the exercise of their fiduciary duty, be able to implement a rights plan or any other defensive measure to fend off an unsolicited take-over bid?

We agree that directors, in the exercise of their fiduciary duty, should be able to implement a rights plan or any other defensive measure to fend off an unsolicited take-over bid. However, as noted in our response to question 1 above, we believe that there must invariably be limits to that discretion.

4. Is it appropriate for Regulators to provide guidance as to appropriate safeguard measures generally recognized as effective in mitigating the inherent conflicts of interest of directors facing an unsolicited take-over bid? If you agree, are you of the view that these measures should be in a policy or in a rule?

We agree that it would be appropriate for Canadian securities regulators to provide guidance as to appropriate safeguard measures generally recognized as effective in

mitigating the inherent conflicts of interest of directors facing an unsolicited take-over bid. This guidance would complement the appropriate degree of competence and skill required of directors under corporate law. We believe that the wording of the question implicitly recognizes that definitive rules and guidelines in this area would be difficult and problematic – with this we agree. Accordingly, in order to provide a level of predictability to market participants and to clarify the context in which policy objectives are applied, we would agree that guidance as to these measures be included in a policy.

5. Do you have any suggestions of effective measures to manage conflicts of interest of directors?

In order to effectively manage conflicts of interests, directors, on advice of counsel, implement various procedures and processes depending on various factors, including the composition of the board, the existence of a controlling shareholder, and relationships of directors with bidders, potential bidders, advisors and other relevant parties. We believe that outlining broad principles are appropriate, but it will be difficult if not impossible to mandate a definitive proper process.

6. Do you believe that security holders generally have the appropriate tools to discipline directors?

We believe that security holders generally have the appropriate tools to discipline directors.

Since the adoption of NP 62-202, corporate governance standards have substantially improved. The significant increase in shareholder activism has allowed shareholders to efficiently and effectively advance their interests through various tools and procedures, including the right of shareholders under Canadian corporate law to requisition a special shareholders' meeting for the removal of directors from office, and the increasing adoption by public companies of majority voting policies.

7. Do you agree that our proposed changes to the take-over bid regime to add the irrevocable minimum tender condition and the extension of the bid would contribute to allow target security holders to make a voluntary, undistorted collective decision to sell?

These two measures are currently found in the "permitted bid" provisions of most security holders' rights plans. While this "permitted bid" concept would address the concern over the perceived structural coerciveness of takeover bids, when combined with deference to directors, we believe that the defensive tactic regime would then be tipped too much in favour of boards. This would be unduly restrictive to bidders and would therefore not be in the public interest. We would rather that the CSA give deference to directors and continue to ensure that directors and shareholders have the appropriate tools to block unsolicited bids that are not considered desirable. Accordingly, we would suggest that a hybrid of the Proposed Rule of the CSA and the AMF Proposal be adopted: see Part I of our response, under "*Basic Elements of Proposed Policy or Instrument*".

8. Do you believe that the AMF Proposal would enhance investor protection against unfair, improper or fraudulent practices and promote the efficiency of capital markets?

Please see our response to question 1 above.

If you wish to discuss any aspect of this letter, we would encourage you to contact any one of the following lawyers who would be pleased to speak to you at your convenience:

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Yours truly,

"*McMillan LLP*"