Submission by Ad Hoc Senior Securities Practitioners Group

July 11, 2013

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marches 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 Territories
Superintendent of Securities, Nunavut

c/o The Secretary
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Background

We are writing in response to the following requests for comment issued on March 14, 2013 (the **Requests for Comment**):

(i) Notice and Request for Comments issued by the Canadian Securities Administrators (**CSA**), proposing new National Instrument 62-105 — *Security Holder Rights Plans*, Proposed Companion Policy 62-105CP, and Proposed Consequential Amendments (the **CSA Proposal**); and

(ii) Consultation launched by the Autorité des marchés financiers (**AMF**) on intervention by Canadian securities regulators in respect of defensive tactics in response to unsolicited take-over bids (the **AMF Proposal**).

We are providing these comments in our personal capacities. They reflect our individual views and not those of our respective firms. Some of our respective firms (or other practitioners in our respective firms) may be making separate submissions to you in response to the Request for Comments, and the views of other practitioners within our respective firms may differ from ours on the issues discussed below.

Each of us is a senior practitioner from a major Canadian law firm. Our collective experience includes acting on change of control transactions for a range of capital markets participants. Our clients regularly include issuers and boards faced with unsolicited bids, bidders acting on both an unsolicited and negotiated basis, and institutional and activist shareholders who are affected by these transactions. As a result, our practice has not biased us in favour of, or against, a particular stakeholder group. We believe that we have a broad and informed perspective on the valid issues raised by each of these stakeholder groups in the context of a potential change of control transaction.

Our submissions are based on our experience and reflect what we believe to be a balanced approach that will: (i) foster fair, efficient and competitive capital markets; (ii) protect the legitimate interests of investors; (iii) facilitate the proper discharge by directors of their fiduciary duties; and (iv) result in a predictable and understandable set of rules that minimizes the need for regulatory intervention.

Key considerations for our submission

The CSA and AMF proposals have considerably advanced the discussion regarding the regulation in Canada of defensive tactics, and shareholder rights plans in particular. Our approach proposed below builds on the valuable ideas and concepts in both proposals, but primarily responds to the CSA Proposal, which would effectively regulate how much time a target board would have to respond to a take-over bid, by regulating how long a shareholder rights plan that has not received shareholder approval may remain effective. Although our response focuses on that proposal, we acknowledge the value in reviewing the overall regulatory regime for defensive tactics that boards may employ in response to an unsolicited offer, beyond those designed to give the board and shareholders more time. In that context, we believe that the AMF Proposal, which attempts to balance the current shareholder-driven approach to the regulation of defensive tactics by permitting a larger role for the board, has significant merit and warrants further consideration. We would welcome a review of National Policy 62-202 *Take-over Bids – Defensive Tactics* and the role of securities regulators and the courts in that context, with a view to achieving a better balance.

Our proposed approach to the issues raised by the CSA Proposal is premised on the following points on which there is broad consensus among us:

> *The current regulatory regime gives ultimate primacy to target shareholder interests and this is unlikely to change in the near term:* Although boards are required by corporate law to balance all stakeholder interests and we believe they should have greater scope to do so when faced with an unsolicited offer, we do not believe that the fundamental shift in the take-over bid regime proposed by the AMF will be supported by the vast majority of the investor community. Our proposed approach is therefore based on the premise (which underlies the existing regulatory regime) that in the context of a potential change of control, shareholder interests have ultimate primacy and there should come a time when shareholders have the opportunity to determine the outcome of an unsolicited take-over bid.

Boards need more leverage and time: Target boards are best positioned to enhance collective shareholder value, but our take-over bid regime (including the current practice and regulatory response in respect of shareholder rights plans) allows bidders significant leverage and therefore creates less incentive for them to engage with the target board; we do not believe that the CSA proposal to permit a rights plan to remain in place for 90 days will change this dynamic.

Formal bids can be structurally coercive: Elements of our take-over bid regime permit bid terms that may pressure shareholders to tender to an unsolicited bid that they otherwise would not support.

Creeping bids should be addressed: Creeping bids permitted by the take-over bid exemptions in our existing regime may undermine the principle that control is generally a corporate asset and, where that is the case, the premium for control should be maximized and shared rateably by all shareholders and the opportunity to participate in a change of control should be available to all shareholders.

All market participants need a clear, consistent and predictable regulatory regime: Regulatory changes should address the regulatory objectives directly, clearly and consistently across the jurisdictions, and reduce the need for intervention by regulators.

Proposed approach

Shareholder rights plans have evolved as a tool to address perceived deficiencies in the take-over bid regime from the perspective of target companies and their shareholders: insufficient time for target boards to respond to unsolicited offers; toleration of potentially coercive bids; and the ability to acquire control through exemptions from the formal bid requirements. **We believe that rather than working with the tool by changing the rules governing when and for how long rights plans may be deployed in the face of a bid (which is the approach proposed by the CSA), it would make more sense, while supporting the stated objectives of the CSA proposal, to address directly the deficiencies in the underlying regime that have prompted the need for rights plans in the first place. This would have the result of making rights plans unnecessary.**

We believe that this can be achieved through the following three changes to the take-over bid regime (drawn from the thoughtful ideas in the CSA and AMF proposals):

(i) *extend the minimum bid period:* change the negotiating dynamic between hostile bidders and target boards and provide boards with more time to seek alternatives to unsolicited offers, by extending the time period during which a formal take-over bid must remain open to at least 120 days (being the minimum we believe is required to change the current dynamic), subject to the discretion of the independent directors of the target to abbreviate that period to no less than 35 days as described below;

(ii) *eliminate coercive bid features:* eliminate elements of the take-over bid rules that may be coercive, by requiring that a formal bid (including a partial bid) (a) be accepted by holders of more than 50% of the affected

class of voting or equity shares and (b) be extended for a minimum 10-day period if the conditions of the offer are satisfied or waived, subject in each case to the discretion of the independent directors of the target to waive or modify these requirements; and

(iii) *change take-over bid exemptions:* discourage creeping bids that may discriminate between shareholders and prevent the rateable sharing of a control premium, by requiring the approval of the independent directors of the target for an offeror to access the private agreement exemption and by reducing the number of shares that may be acquired under the normal course purchase exemption from 5% to 2% of the relevant class in any 12-month period.

Discussion

We discuss below each aspect of our proposed approach and how it would address the issues identified in the Requests for Comments.

(i) Extending the minimum bid period

Our approach is based on our view that target boards are best positioned to oversee and execute a collective target shareholder response in circumstances where a change of control is proposed, but they often need more time to do so than is available under the current regime. The policy debate should therefore focus on the question of the right minimum bid period, whether there should be some flexibility in determining the minimum bid period and, if so, in whose control that flexibility should reside (shareholders, directors, regulators or the courts). We believe that whatever approach is chosen, it should be implemented by changing the bid rules, not by requiring boards to implement a shareholder rights plans to obtain the benefit of a longer minimum period or by leaving the debate to play out before a regulatory panel or court.

Target boards are best positioned to maximize shareholder value

The board of the target is generally in the best position to maximize the price that a bidder is willing to pay to acquire control, to surface and evaluate alternatives to an unsolicited bid and in appropriate circumstances to try to convince target shareholders that they should not accept a change of control proposal. The directors have the most complete information regarding the target's financial and strategic position and the directors also have fiduciary obligations to act in the best interests of the corporation. When a target decides to sell control, it is no surprise that financial advisors uniformly recommend that the board control the sale process, soliciting interest and providing information to prospective bidders subject to "standstill" arrangements that ensure that the potential buyers must deal with the board alone. By controlling acceptance of any bid through a single negotiator (the board) that must act in the target's best interest, the advisors can run a real auction to generate the best price.

We recognize that some capital markets participants are not confident that a target board will act independently to protect shareholder interests when faced with an unsolicited bid. There is a concern that the board will have a natural bias against the bidder and in favour of the incumbent directors and management.

While that natural bias is undeniable, there are offsetting factors at play that, in our experience, discipline target boards and result in boards generally acting prudently in responding to unsolicited bids. In particular, ultimately, boards cannot resist shareholder pressure to cooperate with a hostile bid if holders of a majority of an issuer's shares prefer to receive the bid. In Canada (unlike Delaware, where staggered boards combined with by-law provisions that make director removal more difficult are permitted) those shareholders have the power to remove the board at any time through a majority vote. There would be transaction costs to launching a proxy battle to do so, but in most cases the threat of board removal (or even of a material decrease in shareholder support for the board at the next annual meeting) acts as a sufficient discipline on the board when it is faced with an unsolicited take-over offer. Recent trends (including improved board governance practices, more frequent and aggressive shareholder activism, successful high profile proxy battles, the increased use of litigation tactics in hostile bids and the increasing prevalence of majority voting policies for directors) have created a meaningful counterbalance to potential management and board conflicts.

Boards need more leverage and time

Recognizing that a well-advised board is in the best position to negotiate with an unsolicited bidder and to attempt to surface and consider alternatives to the unsolicited bid means also recognizing the desirability of ensuring that the board has adequate time to do so effectively. There appears to be consensus that the present timeframe provides too much leverage to a hostile bidder, makes it very difficult for the target board to negotiate a better offer from the hostile bidder absent an alternative transaction, and may in some cases be insufficient for boards to bring forward alternatives. However, there is a lack of consensus as to what period of time would be sufficient to overcome those concerns and create a better balance between target boards and hostile bidders. Currently, a formal bid must remain outstanding for no fewer than 35 days and a board can extend that to approximately 55 days by implementing a shareholder rights plan. The CSA Proposal is effectively advocating that boards be permitted to extend unilaterally the minimum bid period to 90 days, or even longer with shareholder support. We propose instead that all take-over bids be required to remain outstanding for at least 120 days, but that the target board be permitted to shorten the minimum period to not less than 35 days, provided any competing bids receive consistent treatment, as discussed below.

A minimum bid period of at least 120 days is critical to our proposal and is based on our experience advising both targets and bidders. There will be many circumstances in which the target's business is sufficiently complex that a number of months are required to identify prospective acquirers, allow them to conduct diligence and negotiate a transaction. In our experience, 90 days is often not long enough to do this effectively. In a managed sale process, it can often take four to six months, or longer, to reach the stage where a binding agreement is executed. Further, in the context of an unsolicited offer, the process of seeking alternatives may have to be initiated at an inopportune time. Unsolicited bidders are typically opportunistic, choosing a point in the business cycle when market conditions, financial circumstances or other constraints have weakened the target's share price or bargaining position, so that the bidder can obtain control at the lowest possible price. Allowing the board additional time will mitigate the risk that short term factors may exaggerate the apparent premium being offered. It may also reduce arbitrage trading that is predicated on the likelihood that a change of control will occur once a potential transaction is announced, rather than on the merits of that transaction. It also

enables the directors to mediate interests, as they are required to do under corporate law. This challenge is particularly acute when shareholder interests are not homogenous or are not aligned with the legitimate interests of other stakeholders of the corporation.

However, this is fundamentally not merely about allowing a target board adequate time to identify and solicit interest from other bidders. The adequacy of the time period is also driven by the need to create negotiating leverage opposite the unsolicited bidder. As noted in the CSA Proposal, there may be very little pressure on a hostile bidder to negotiate with management and the board when it knows that after a period of six to eight weeks, its bid will likely be able to proceed. To advance alternatives and create effective negotiating leverage, the target board needs a period long enough to create real uncertainty as to whether an unsolicited offer will succeed and to make obtaining the target board's cooperation valuable to the bidder, therefore encouraging an unsolicited bidder and potential competing bidders to the bargaining table. Without that tension, a target board is effectively required to conduct a "fire sale" process in which it is unlikely to achieve the best result for its shareholders. We do not believe that the 90-day period in the CSA Proposal is sufficient to change the current dynamic.

We do not believe that boards will be able to use a 120-day minimum bid period to defeat an unsolicited offer in the absence of a credible alternative or a compelling strategic plan. It will be open to shareholders to requisition a meeting to remove the board prior to the expiry of the 120-day period, if they believe that the directors are acting improperly. And, regardless, the directors will have to face shareholders at the next annual meeting. This remains a significant and very real discipline on their actions (as do their statutory duties under corporate law).

Boards should be permitted to abbreviate, but not extend, the minimum bid period

There may be circumstances where the 120-day period is too long. We submit that a majority of the target's independent unconflicted directors should be able to curtail the period, in their discretion, to no less than 35 days from the date the offer is made. If the target board (through its independent unconflicted directors) does so for one offer (the "abbreviated offer"), any competing offer should receive consistent treatment. The mechanics for this should provide that:

(a) if a prior offer, made before the abbreviated offer, remains outstanding and has an expiry date that falls after the expiry date approved by the target board for the abbreviated offer, the prior offer may be amended so that its expiry date is coterminous with the expiry date of the abbreviated offer[1];

[1] The mechanic in (a) may be illustrated with the following example: Bidder A makes a bid on Day 0 with a 120-day minimum bid period that expires on Day 120. On Day 40, Bidder B makes a bid with a 35-day bid period that expires on Day 75, as a result of the target board waiving the minimum bid period down to the 35-day minimum. Bidder A would then be permitted to amend its bid to expire on Day 75 as well, so that Bidder A's bid is co-terminus with the bid by Bidder B. Bidder A's total bid period would therefore become 75 days, rather than 120 days (the original minimum bid period) or 35 days (Bidder B's bid period).

(b) the minimum bid period for any offer commenced after the abbreviated offer would be the same as the bid period approved by the target board for the abbreviated offer[2]; and

(c) if an offer is commenced with a 120-day minimum bid period that is subsequently abbreviated, the minimum bid period for any offer commenced after that would be the same as the cumulative period during which the abbreviated bid was required to be outstanding. [3]

We appreciate that this aspect of our proposal will allow unsolicited bidders to exert timing pressure on a target board notwithstanding the 120-day minimum bid period. Bidders could do so by announcing an intention to bid, but only if the target board reduces the minimum period, or by launching a bid that is conditional on the target board reducing the 120-day period, possibly with a concurrent proxy contest to remove the board if it fails to do so. However, we do not believe this power to exert pressure will materially undermine the objectives of our proposed approach. The tension created by this pressure would maintain an appropriate balance of power, and should result in a higher incidence of negotiated, supported transactions, to the benefit of the capital markets. The tension should also act as a further discipline on target boards to act responsibly given the inevitable shareholder scrutiny of their response.

The current approach, in which issuers adopt shareholder rights plans to effectively extend the minimum bid period beyond 35 days, puts securities regulators in the position of arbitrating whether the board has had sufficient time to find a credible alternative and is using reasonable efforts to do so. In our view, this is neither a productive exercise for securities regulators nor does it encourage the best result for shareholders. When a bidder challenges a shareholder rights plan, the securities regulator conducts a hearing in which it considers whether the target is actively pursuing alternatives that are likely to mature into a competing transaction in the short term, or whether "the time has come for the pill to go", in which case it will issue a cease trade

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[2] The mechanic in (b) may be illustrated with the following example: Using the same scenario as described in footnote 1, assume that Bidder C makes a bid on Day 50. Bidder C will be entitled to impose a 35-day bid period and its bid could expire as early as Day 85 to correspond to the bid period that the target board allowed Bidder B. As a result, Bidder C's bid will expire after Bidder B's bid (it will not be co-terminus) but Bidder C (and any future bidder who makes a bid while Bidder B's bid is outstanding) will be entitled to the benefit of the same minimum bid period that the target board allowed Bidder B.

[3] The mechanic in (c) may be illustrated with the following two examples: Bidder A makes its bid on Day 0 with a 120-day minimum bid period that expires on Day 120. On Day 35 the target board successfully negotiates an agreement with Bidder A. The target board could waive the minimum bid period for Bidder A down to as few as 35 days, but as a practical matter Bidder A would have to extend its offer to at least Day 45. This is because although Bidder A's bid would have already been outstanding for at least 35 days (the minimum to which the target board could waive), Bidder A would presumably have to vary its offer to reflect the agreement and therefore would have to extend its offer for at least 10 days. If Bidder B then makes a bid on Day 40, Bidder B would be entitled to impose a minimum bid period of 45 days, being the minimum bid period for Bidder A's abbreviated offer including the required 10-day extension, and Bidder B's bid could expire as early as Day 85. Similarly, if the target board and Bidder A were not able to negotiate an agreement until Day 55, the target board could waive the minimum bid period for Bidder A down to as few as 35 days but as a practical matter Bidder A would have to vary its offer to expire no earlier than Day 65 (allowing for the required a 10-day extension for a variation). Therefore, if Bidder B made a bid on Day 60 in that example, Bidder B would be entitled to impose a minimum bid period of 65 days, being the minimum bid period for Bidder A's abbreviated offer including the required 10-day extension, and Bidder B's bid could expire as early as Day 125.

order. This approach can lead to inconsistent treatment of bids and uncertainty as to how long a board will have to pursue alternatives to a bid. As well, the regulators must render their decision with less than complete information regarding the target and its prospects, based on a short hearing process conducted under tight time constraints. This has led to the current arbitrary result that a shareholder rights plan will be effective to forestall an unsolicited bid for approximately 45 to 55 days. Further, the exercise ignores one of the key objectives of requiring a longer period, which is to protect against purely opportunistic timing on the part of the bidder and provide the board with negotiating leverage, regardless of the status of any alternatives it may then be pursuing.

In our view, the directors are generally in the best position to determine the time required to negotiate the most attractive transaction for the target or to convince shareholders of the merits of their strategic plan. Again, we acknowledge that there may be concerns that the directors will misuse this authority to entrench their position. However, this concern is mitigated by our proposal that directors not be able to extend the bid period beyond the proposed minimum period of at least 120 days. In addition, for the reasons we have articulated above, we believe that there are sufficient disciplines in the system to deal with potential director conflicts and we are proposing that the power be exercised only by independent directors who are not conflicted in relation to the particular offer.

We considered whether the target's shareholders should have the power to abbreviate the minimum bid period, either in advance or at the time the unsolicited bid is launched. In our view, however, neither alternative is desirable. The adequacy of the time period will invariably depend on the circumstances at the time the offer is made and thereafter, and a determination in advance cannot properly address those issues. And leaving the power to abbreviate the period to the shareholders at the time an offer is made will undermine the board's negotiating position by allowing an unsolicited bidder to circumvent the board and go straight to the shareholders within the minimum bid period. This would defeat one of the key objectives of the longer period. As noted above, shareholders would always have the ability to requisition a shareholders meeting to remove the target board.

We recognize that there must however be a reasonable limit on the board's ability to delay a bid, so we do not propose that boards be allowed to further extend the minimum bid period even if they determine in good faith that doing so is necessary to identify a better alternative. We considered in that context whether a target board should at least have the ability to extend the minimum bid period beyond 120 days with shareholder approval. However, our proposal below to impose an irrevocable minimum tender requirement of over 50% and a mandatory 10-day extension for a successful bid should operate to protect shareholders if a majority believe that the target board needs more time: shareholders may, in those circumstances, reject the bid without facing the risk of being left behind. Therefore, we concluded that, provided the minimum bid period is at least 120 days, the right balance is for shareholders not to be able to require directors to abbreviate the period and for directors not to be able to extend it, even with shareholder approval.

Shareholders Decide After Expiry of Minimum Bid Period

After 120 days (or a shorter period if approved by the Board), the decision as to whether to accept or reject a bid would rest with the holders of a majority of the target's shares. This would be accomplished through the elimination of the ability of a target board to use a shareholder rights plan to extend the minimum bid period further and by the implementation of an irrevocable minimum tender condition of 50.1%, as discussed below under "Irrevocable Minimum Tender Condition and Mandatory Bid Extension" (the latter being a feature included in the permitted bid provisions of most Canadian shareholder rights plans). In this way, our proposed approach would continue the current policy of the Canadian bid regime that target shareholders should ultimately determine the success or failure of a take-over bid.

Change take-over bid rules to implement new timeframe

Although reasonable people may differ as to what will be sufficient time for the target board to respond, we believe the availability of a longer timeframe should not depend upon the board implementing a shareholder rights plan.

The standard shareholder rights plan includes detailed mechanics that do not serve the policy objectives of either the CSA Proposal or the AMF Proposal. Those mechanics were developed as a technical way for a target board to control a bidder's ability to take up shares without the board's cooperation. The mechanics are cumbersome and not the right vehicle for implementing policy changes. As well, there is uncertainty as to whether the plans technically comply with corporate law, regardless of whether the directors have acted properly, because the plans contemplate treating holders of the same class of shares differently.

In addition, requiring a target board to implement a shareholder rights plan to increase the minimum bid period and allowing the target shareholders to force removal of that plan by requisitioning a special shareholder's meeting will inevitably lead to proxy battles and possibly litigation over whether the target board is acting properly in setting the meeting date and conducting the proxy fight, and whether the proposed terms of the shareholder rights plan are acceptable. Even if the target board is ultimately successful in obtaining shareholder approval, the process will distract any value maximization process and create uncertainty as to whether it will be allowed to play out. Proxy advisory services such as ISS and Glass Lewis may also become involved in pre-approving rights plans in this context, with the result that they, rather than securities regulators, will become the arbiters of permitted bid features and the appropriate minimum bid period.

Therefore, rather than regulating shareholder rights plans as a way to give target boards more or less time to respond to an unsolicited offer, we suggest that the take-over bid rules be amended to extend the minimum time period for a bid to at least 120 days and allow the independent unconflicted target directors authority to abbreviate that timeframe as discussed above.

(ii) Irrevocable Minimum Tender Condition and Mandatory Bid Extension

In our view, the AMF Proposal includes compelling proposed improvements to the take-over bid regime to address potential structural coercion, particularly in the context of hostile bids. Those

changes would involve adopting two common features of shareholder rights plans into the take-over bid rules, namely:

(a) imposing an irrevocable minimum tender condition for bids (whether they are bids for all the securities of a class or partial bids), requiring more than 50% of the outstanding securities owned by persons other than offeror and its joint actors to be tendered in order for the bid to succeed; and

(b) requiring bids to be extended for an additional 10-day period after the minimum tender condition has been achieved.

We agree with the AMF's rationale for these proposed new rules. Shareholders faced with a take-over bid may feel forced to tender their shares even if they do not want the bid to succeed, to avoid the risk of being left behind should the bid be successful. Failing to tender may result in the shareholder either being left with an illiquid security and not participating in the benefit of any control premium implicit in the bid, or being subject to a forced "squeeze-out" transaction in which it would receive the same consideration but on a delayed basis. Without the two proposed protections, shareholders are forced to act individually and there is a potentially coercive element that would result in more tenders than might otherwise occur.

These coercive factors are not present when a change of control transaction is structured as a transaction that requires approval by a shareholder vote (such as an arrangement or amalgamation). In those transactions, the bidder must obtain approval of holders of at least two-thirds of the shares and, where the transaction is a business combination to which MI 61-101 applies, holders of a majority of the shares not held by the acquirer and its joint actors. As well, if a voting transaction receives the required approvals, all shareholders are bound, ensuring equal treatment even of those shareholders who vote against the transaction. In our view, there is no logic for treating bids differently. From the perspective of their impact on the shareholders' ability to participate in a premium for control, the transactions are the same however effected. The two proposed changes would therefore put bids (whether solicited or unsolicited) on a similar footing with voting transactions in terms of the need to obtain collective shareholder support and treat shareholders equally if that support is achieved.

We do, however, believe that these two requirements should be capable of waiver or modification by a majority of the target's independent unconflicted directors. Just as we would propose that these directors have the ability to reduce the minimum bid period, we believe they should have the ability to relax these requirements in appropriate circumstances, subject to the discipline of corporate law duties. Those circumstances may include, by way of example, transactions with strategic partners or unique facts that make an "any or all" bid less of a concern. We believe that if target directors are given the opportunity to negotiate terms and conditions of a bid (as they are, by definition, in all "friendly" bid situations) their ability to waive or modify these requirements is complementary to the exercise of their duty to act in the best interests of the corporation. To the extent that raises concerns that target directors would abuse their discretion, we would support the introduction of a policy statement outlining the circumstances in which securities regulators would be likely to intervene and override a waiver in the exercise of their public interest jurisdiction. Such a policy statement could include

guidelines regarding the use of the discretionary waiver in the context of an insider bid or where there are competing bids.

We note that if these changes are made, consequential changes will be required to permit a bidder to take up, but not pay for, securities until after the 10-day extension, to allow any necessary pro rating to occur after all tenders are made rather than on the first take up.

(iii) Changing take-over bid exemptions

There is another feature of shareholder rights plans that would be desirable to import into the take-over bid regime. That feature prevents creeping bids.

Under the current take-over bid rules, an offeror may acquire shares in a transaction that would otherwise be a take-over bid without making a formal bid to all shareholders on the same terms, by relying on one of two key exemptions. They are:

(a) the "private agreement" exemption, which allows an offeror to acquire shares pursuant to an offer to five or fewer vendors at a price not exceeding 115% of the market price, and

(b) the normal course purchase exemption, which allows an offeror to acquire up to 5% of an outstanding class of voting or equity shares in any 12-month period, provided there is a published market for the shares and the purchases are made at the market price.

The original rationale for the private agreement exemption was a pragmatic one. The exemption established a delicate balance between the interests of minority shareholders who seek equal treatment on a change of control and the interests of controlling shareholders who wish to reap the rewards of their entrepreneurial activity[4]. The theory was that the exemptions would not undermine the principle that, where control is a corporate asset, shareholders should have an equal opportunity to benefit from the payment of a premium for control, because the exemption does not allow a premium to be paid. Although it permits the purchase price to be up to 115% of the market price, the additional amount was intended to provide an element of price protection (in light of normal market movements) and to recognize that a purchaser may pay an additional amount to save the costs (including potential price impact) of buying the block over time.[5] We understand the private agreement exemption may also be used as a means to provide liquidity to significant shareholders in circumstances where there is not sufficient market liquidity to permit the sale of a position on an exchange without adversely affecting the sale price.

Conversely, the normal course purchase exemption limits acquisitions to 5% of the outstanding class and requires the shares to be acquired at a market price. The justification for the exemption

[4] *Proposed Changes to Provincial Securities Legislation — Take-over bids*, Request for Comments dated June 8, 1990, 13 OSCB 2295 at 2297.

[5] Securities Industry Committee on Take-over Bids, *The Regulation of Take-over Bids in Canada: Premium Private Agreement Transactions* (November 1983).

is that the transactions occur at the market price, providing liquidity for sellers in transactions that do not involve the payment of a control premium.

It is fair to ask whether the balance between the competing interests should be struck differently today. Even if the vendors do not exact a "control premium", creeping acquisitions may nonetheless result in the acquisition of legal or effective control without adequate *pro rata* compensation to all shareholders and may diminish the likelihood that a bidder will pay a premium for control in the future. As well, the ability to continue accumulating shares in excess of 20% on an exempt basis may make it very difficult for a target board to attract competing transactions that are not supported by the significant holder, given that a position of that size may allow the holder to effectively block a control transaction. As a result of these concerns, target boards often regulate this activity themselves by implementing shareholder rights plans that prevent creeping bids that would otherwise be exempt from the take-over bid rules. Proxy advisory services such as ISS typically support plans containing these features. Financial advisors often recommend that issuers implement plans that prevent creeping acquisitions even in the absence of an actual or anticipated unsolicited formal bid, to ensure that the board retains its negotiating position if faced with one in future.

For the same reasons we noted above in relation to extending the minimum bid period, it is undesirable to require a target board to implement a shareholder rights plan to restrict creeping bids if there are the sound policy reasons for the restrictions. We therefore propose that the take-over bid rules be amended to limit these two exemptions as follows.

Private agreement exemption should require target board approval

First, we suggest that an offeror be prohibited from accessing the private agreement exemption except with the approval of the independent unconflicted directors of the target issuer.

We recognize the need for a safety valve to permit private agreement transactions and therefore believe it is appropriate to provide the board with flexibility to approve private agreement transactions (subject to the current price cap of 115% of the market price) that provide liquidity to significant shareholders where doing so does not adversely affect the target or may be advantageous for the target, for example by introducing a new strategic investor or resolving ownership issues that are adversely affecting the target. Permitting the exemptions to be used with independent board approval would allow independent unconflicted directors (who have a fiduciary duty to act in the target's best interests and to take into account and protect the reasonable expectations of its shareholders) to balance the competing interests at play. Directors who are related to the controlling shareholder or to the proposed purchaser would not be treated as independent for this purpose.

This approval requirement would also give target boards a seat at the table in a transaction that is a take-over bid not made available to all holders, to negotiate protections against the buyer exercising control without paying for it (such as agreements on independent board representation and standstills) or benefits for the target that balance any potential impact on control.

If the private agreement exemption is eliminated or restricted, a more focused exemption should be added to permit transfers between affiliates and corporate reorganizations to occur on an

exempt basis. Currently it is common to use the private agreement exemption for these purposes.

Reduce normal course purchase exemption to 2% in any 12-month period

Second, we suggest restricting the normal course purchase exemption to permit purchases of up to only 2% of a class of voting or equity shares in any 12-month period. The choice of 2% rather than 5% is somewhat arbitrary. It is based on our judgment that when a holder already has 20% or more of the relevant class, the addition of a further 5% is more likely to have a significant adverse effect on the issuer's ability to engage in a future control transaction, whereas the addition of a further 2% is less likely to do so.

Eliminate or reduce bidder's ability to make normal course purchases during a formal bid

Finally, we also recommend either eliminating the current exception that allows a bidder to make normal course purchases while its formal take-over bid is outstanding, or reducing it from 5% to 2% to correspond to the reduction of the normal course purchase exemption we propose above. We do not see a clear policy rationale for this exception and it arguably undermines the objective that shareholders be treated equally on a take-over bid. This will particularly be the case if regulators introduce the further protection we recommend above, to require any take-over bid to be accepted by holders of more than 50% of the securities subject to the bid before it can proceed. For those reasons, we propose either that the exemption be eliminated or, if that elimination would be viewed as an undue restriction on liquidity, that it be reduced to 2%.

(iv) Potential Elimination/Expected impact on use of shareholder rights plans

As noted above, shareholder right plans have typically been used by target boards to obtain more time to respond to unsolicited offers, to prevent some of the coercive elements of take-over bids currently permitted under our rules, and to prevent creeping bids. If our recommended reforms are adopted to increase the minimum bid period to 120 days, we propose that the securities regulators eliminate the ability for boards to use shareholder rights plans for the purpose of regulating the time period during which a formal take-over bid must remain open. As a result, any shareholder rights plan with such a feature would be cease traded automatically (subject to transitional provisions for existing plans). If securities regulators also adopt the new protections proposed above to address structural coercion and to narrow the take-over bid exemptions that allow creeping bids, we would expect target boards generally not to adopt shareholder rights plans because they would serve no purpose and we would support additional rules or changes in the law that effectively eliminated them entirely for transactions that are subject to the CSA take-over bid regime.

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We appreciate the opportunity to make these submissions.

Respectfully submitted by:

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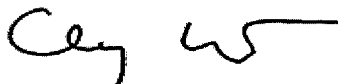
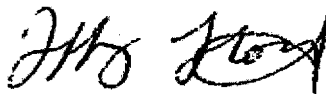
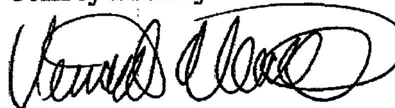
Stephen H. Halperin



Clay Horner



Jeffrey R. Lloyd



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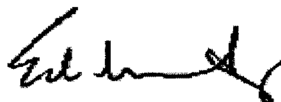

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