McCarthy Tétrault LLP
PO Box 48, Suite 5300
Toronto-Dominion Bank Tower
Toronto ON M5K 1E6
Canada
Tel: 416-362-1812
Fax: 416-868-0673

mccarthy tétrault

July 11, 2013

Via Email

The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 2S8
comments@osc.gov.on.ca

Anne- Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montreal, Québec H4Z 1G3
consultation-en-cours@lautorite.qc.ca

Dear Sirs/Mesdames:

Re: CSA Notice and Request for Comment - Proposed National Instrument 62-105 Security Holder Rights Plans

Thank you for the opportunity to comment on the proposed National Instrument 62-105. We have set out below our response to each of the questions in the CSA's Request for Comment. We also welcome the opportunity to comment on the separate Consultation Paper of the *Autorité des marchés financiers – An Alternative Approach to Securities Regulators' Intervention in Defensive Tactics* (the "AMF Proposal"), which we will do at the end of this letter.

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 certainly agree that the status quo in Canada for the regulation of Rights Plans could be improved. The current situation, where securities commission hearings are routinely required and the timing of the termination of the Rights Plan is uncertain, involves a substantial investment of time and money. Avoiding these unnecessary costs would be desirable. In addition, the conflicting decisions in different provinces, and sometimes within the same province, are not helpful if the goal is an efficient capital market where

both bidders and targets (and their advisors) understand the rules.

The suggestion that the CSA could mandate permitted bid conditions and disallow Rights Plans is interesting. A similar thought would be to disallow Rights Plans and simply change the current minimum bid period from 35 to 90 days, with the bidder being entitled to shorten that period with the consent of the target's board of directors. Friendly, negotiated transactions could then still be done on a 35 day timetable. That would avoid a significant disadvantage of the Proposed Rule, which is that it is likely to make proxy contests a necessary part of many hostile take-over bids, which will add a significant cost to what is already an expensive process. The downside of this alternative proposal is that it would prohibit Rights Plans in all cases, and that is not a good idea. Even with a 90 day bid period, Rights Plans still have a legitimate role in, for example, blocking creeping bids. On balance, we prefer the Proposed Rule.

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.*

Presumably, under the Proposed Rule there would in almost all cases be no need for securities regulators to review Rights Plans. Either they would be approved by shareholders, in which case the regulator should not intervene, or they would die a natural death either at a shareholders meeting where the Plan is voted down (either a special meeting or the next AGM) or at the 90 day expiry date.

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

As noted above, the Proposed Rule in its current form would likely make proxy contests a necessary part of many hostile take-over bids. This will complicate the process and make it more expensive for all market participants. Where a Rights Plan has been enacted in response to a hostile bid, our view is that the process would be simpler and more cost efficient if the Rule provided that the Rights Plan would remain in place (unless waived by the target's board) until the later of (i) 90 days from the date the bid was commenced, or (ii) the date on which a majority of the shareholders approve of the termination of the rights plan at a meeting or by written consent (including by way of power of attorney granted by tendering shareholders to a bidder pursuant to a Letter of Transmittal). In our view, allowing the shareholders to terminate the Rights Plan by written consent would avoid the unnecessary cost and distraction of holding a shareholders' meeting during the bid process, and would lead to the same result as the Proposed Rule. In order to avoid coercion in the bid, the Rule could require that the form of Letter of Transmittal allow shareholders to separately vote on the Rights Plan and the bid, and could also require that a bidder extend its bid for 10 days in the event that a Rights Plan is voted down.

We do not suggest that a written consent be available to terminate a Rights Plan where the Rights Plan was enacted in advance of any bid and has already been approved at a shareholders' meeting. In that case, the shareholders' have presumably intended to grant the board discretion to deal with hostile bidders as the board sees fit until the next annual or special meeting of shareholders (unless a bid complies with any applicable "permitted bid" conditions). This approach would respect the decision by shareholders in approving a Rights Plan to vest a target board with leverage in negotiations with any

hostile bidder until the target's next shareholders meeting.

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

Under the Proposed Rule, where the shareholders have approved a Rights Plan, the target company board might be able to "just say no" without further shareholder approval until the next AGM, possibly a period of well over one year. If the shareholders want the Rights Plan removed, they can vote it out at the next AGM or requisition a meeting earlier to remove it. We believe that shifts the current balance of power somewhat from the hostile bidder to the target board, but the consensus within our firm is that, given the shareholder approval of the Plan, that shift is appropriate.

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 a 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.*

As noted above, we believe the Proposed Rule will shift the balance of power somewhat from hostile bidders in favour of target boards. We also think that the cost of a hostile bid will increase if a shareholder meeting must be called to vote on a Rights Plan. We do not believe, however, that hostile take-over bids will be "unduly discouraged".

6. *Do you believe that other changes or consequential amendments to applicable securities legislation will be necessary if the Proposed Rule is implemented? Please explain*

If a hostile bidder wishes to challenge a pre-approved Rights Plan (rather than comply with any applicable "permitted bid" conditions in the Rights Plan), and the target's next annual meeting will not be held in the coming months, the bidder may need to acquire 5% of the target's shares so that it can requisition a shareholders meeting to remove the Plan. That can be a significant cost, and a significant risk. The bidder is likely to drive up the market price of the target's stock with its buying activity, and then drive the value down as it unwinds the position if the transaction does not proceed – not a good career move for the CEO or CFO of the bidder.

As an alternative to buying a 5% position in the target in order to requisition a meeting, hostile bidders may try to enter into lock-up and voting agreements with up to 15 target shareholders holding at least 5% of the target shares to provide, in addition to the tender of shares under the bid, the support of such shareholder(s) in requesting a meeting to consider terminating the rights plan. To enable this alternative, we would recommend clarifying whether the target shareholder(s) entering into such agreements would be deemed to be acting jointly or in concert with the hostile bidder which could raise obvious issues for the target shareholders and the bidder. The regulators may want to consider modifying Section 1.9(3) of Multilateral Instrument 62-104 to provide that "a person is not acting jointly or in concert with an offeror solely because there is an agreement, commitment or understanding that the person will (A) tender securities under a take-over bid made by the offeror that is not exempt from Part 2, (B) requisition a meeting of securityholders to terminate a rights plan of the issuer or (C) vote in favour of a termination of a rights plan of the issuer at a meeting of securityholders.

Specific

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?*

   (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 think a 90 day period strikes a reasonable balance as between bidder and target.

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.*

   As noted above, we believe the 90 day period is appropriate, and an improvement upon the current regime.

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?*

   No. Letting the Plan expire after 90 days if no shareholder meeting is called is fine.

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 year after the issuer first obtained security holder approval.*

   (a) *Is this timing appropriate?*

   (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.*

   With respect to timing, we think the Proposed Rule is fine.

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?

We do not think that management or any other shareholder group should be disenfranchised from voting, other than the hostile bidder. We understand that management may be motivated by different considerations than other shareholders, but all shareholders are unique and are motivated by their own individual circumstances. Each shareholder is entitled to vote in his or her own best interests.

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?*

We do not have a consensus on this point within our firm or amongst our clients. Some believe the target Board should not be entitled to indefinitely restrict a shareholder from selling, so that Rights Plans should not apply to Lock-up Agreements. In addition, as noted in our response to question #6, it may be important for bidders to be able to enter into Lock-Up Agreements in order to be able to requisition a meeting. Others recognize that a target Board may be unable to do much to maximize shareholder value if a significant number of shareholders have signed irrevocable Lock-up Agreements, and so believe that it is appropriate for Rights Plans to prohibit that.

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?*

If Rights Plans have to be approved by shareholders annually at the AGM, or within 90 days of a tactical Plan being adopted, it will presumably be exceedingly rare that the Plan will need to be amended at other times. We believe that a requirement that material amendments be submitted to shareholders makes sense and is consistent with many trust indentures that create securities.

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?*

No. The requisition of a shareholders meeting leads to significant costs and distraction for a target company. A hostile bidder that does not hold a meaningful stake in the target company (and does not have the support of shareholders holding 5% of the target company through lock-up and voting agreements) should not have the power to requisition a meeting. If a Rights Plan has been enacted in advance of a bid and has been approved by the target's shareholders, then the wishes of those shareholders should be respected and the target should not be thrust into a proxy battle by any bidder that comes along. We also think it is appropriate that the Proposed Rule does not have a requirement for the target board to call a requisitioned meeting within a prescribed time frame. The timing of that decision should be determined by the board in

accordance with its fiduciary duties, with the Courts available to intervene if the Board acts contrary to these duties.

15. *Section 5 of the Proposed Rule provides a general exception from security holder approval for new reporting issuers. Should this exception be limited or subject to conditions depending on the manner by which the issuer becomes a reporting issuer or the circumstances of the transaction (for example, if the new reporting issuer is a spin-out of another reporting issuer)?*

The exception makes sense to us. If the Rights Plan is fully described in the IPO documentation, that should suffice for "shareholder approval".

16. *The Proposed Rule includes a transition provision in section 10. Is the time period contemplated in this provision appropriate?*

Yes.

We also welcome the opportunity to comment on the AMF Proposal which provides for a broader approach to defensive tactics and proposes fundamental changes to the current regime that would provide greater powers to a target's Board. We do not have a consensus within our firm or amongst our clients as to whether the ultimate decision with respect to a sale of a company should rest solely with the Board, as proposed by the AMF Proposal, or rather with the shareholders having the benefit of all relevant information from the bidder and the target's Board. We do however welcome the fact that the AMF proposal creates an opportunity to consider alternatives to the current regime which are far broader than the approach of the CSA Proposed Rule and suggest that such broader review also include a discussion of National Policy 62-202.

The AMF Proposal would bring the Canadian regime as regards defensive measures more in line with the US (Delaware) regime, where boards have generally been able to "just say no" to a hostile bid by implementing a rights plan or other effective defensive measure. Some feel that the CSA Proposed Rule will not address the oft-cited concern that opportunistic take-over bids, in the vast majority of cases, inevitably lead to a sale of the target. In contrast, this concern would likely be mitigated to a significant extent under the regime contemplated by the AMF Proposal.

Interestingly, and by way of comparison, under Delaware law the judicial standard of review in the case of a board adopting defensive measures, including a rights plan, is not the business judgment rule but the one of "enhanced judicial scrutiny" expressed in the recent *Airgas* decision. In some circumstances, where a conflict of interest exists, the even higher standard of "entire fairness" is imposed by Delaware Courts. While the business judgment rule is well entrenched in Canadian jurisprudence (such as in the *BCE* decision), to our knowledge no Canadian Court has yet applied to board decisions such an "enhanced judicial scrutiny" standard of review. If the AMF Proposal is adopted, consideration will need to be given to whether the current business judgement rule as articulated by Canadian Courts to date is sufficient, or whether increased power in the hands of the directors (rather than the Commissions) should mean a higher level of scrutiny by the Courts.

We also observe that if the Courts are to be the forum for supervising the actions of directors, there is a significant hurdle to accessing the Courts given that bidders may not be granted standing to challenge the actions of a board of directors. Courts would need to be receptive to fiduciary duty claims being brought by shareholders at the prompting of a bidder, or by a bidder who holds shares itself, without characterization of the claim as that of a "bitter bidder". It's a practical, but real, impediment to having the conduct of the target board reviewed by a Court.

We note as a final observation that in February of this year, the Québec Minister of Finance announced that he would launch a consultation regarding new powers and tools that could be granted to Boards of Québec companies to defend against hostile bids. Potential changes to the *Business Corporations Act* (Québec) have also been mentioned by the Minister to give additional powers and tools to Boards to potentially "just say no" to hostile bids. Coordinating any such changes with the other provinces would be highly desirable if that can be done.

Yours truly,

McCarthy Tétrault LLP