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July 12, 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 Territories
Superintendent of Securities, Nunavut

The Secretary
Ontario Securities Commission
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Me Anne-Marie Beaudoin
Corporate Secretary
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Dear Sirs/Mesdames:

Re: Request for Comments – Proposed National Instrument 62-105 *Security Holder Rights Plans*, Proposed Companion Policy 62-105CP, and Proposed Consequential Amendments

Thank you for the opportunity to provide comments to the Canadian Securities Administrators (the "**CSA**") in connection with your proposal of National Instrument 62-105 *Security Holder Rights Plans*, Companion Policy 62-105CP *Security Holder Rights Plans* and consequential amendments to related CSA policies and instruments (collectively, the "**CSA proposal**").

We have considered the CSA proposal in conjunction with the consultation paper published concurrently by the Autorité des marchés financiers (the "**AMF**") inviting comment on an alternative approach to the regulation of defensive tactics (the "**AMF paper**"). The AMF paper notes the CSA's limited focus on shareholder rights plans, and proposes a broader review of the existing regulatory framework with respect to defensive tactics. The primary object of such a review, according to the AMF, would be to "restore the regulatory balance between bidders and target boards" in light of the current "structural imbalance between bidders and target boards, the lack of deference to the decisions and actions of boards, the inability of directors to contemplate measures other than the sale of the target corporation, and the prevalence of security holders' decision to tender in all circumstances."

We note that our firm acts for a number of participants in the Canadian capital markets, including public issuers. While the matters discussed in the CSA proposal and the AMF paper are of significant interest to our capital markets clients, this letter is not written on behalf of any particular client or group of clients. The views expressed in this letter are those of the Bennett Jones lawyers and counsel who have participated in its preparation.

General Comment

As discussed below, we support the broader review proposed by the AMF. We believe that it is time to reconsider the active role played by Canadian securities regulators in regulating defensive tactics under National Policy 62-202 *Take-Over Bids – Defensive Tactics* ("**NP 62-202**"). While the CSA proposal would be an improvement over the current regime, it continues the CSA's current "passive board" policy by maintaining the current restrictions on actions that target boards may take in responding to hostile takeover bids.

Under current policy, the most plausible alternative available to a target board subject to a hostile bid, other than recommending shareholders not tender to the hostile bid, is to seek a "white knight" willing to pay a better price—in effect, to auction the corporation to the highest bidder. We believe that directors of Canadian public corporations should have greater power to fulfill their fiduciary duty to act in the best interests of the corporation and to consider the interests of its various stakeholders as mandated by corporate law. That power should include the ability to adopt shareholder rights plans, without shareholder approval, and to take other defensive measures against inadequate, coercive and opportunistic bids, if the board determines such actions to be appropriate in the reasonable exercise of its fiduciary duties. The powers of shareholders under corporate law to remove directors, to requisition shareholder meetings, and to challenge breaches of fiduciary duties in court, provide a powerful check on the exercise of directorial authority, without the need for further regulatory action by the CSA.

The debate surrounding the role of the board in responding to hostile bids is of central importance to Canadian public corporations, their shareholders, their employees and other stakeholders. The CSA and the Toronto Stock Exchange (the "**TSX**") have taken the view that management entrenchment is a primary and abiding concern, justifying the severe restrictions currently imposed on the use of defensive measures by Canadian corporations. The CSA proposal refers to this as "the over-arching concern that, in the context of a hostile take-over bid, the interests of management of the target corporation may not coincide with those of shareholders and that management may implement defensive measures that deny shareholders

the ability to respond to a bid."[1] Similarly, TSX rules require approval of shareholder rights plans within six months of adoption, regardless of CSA rules.

In our view, the CSA and the TSX have not adequately considered the adverse consequences of current policy and, conversely, the desirable effects of empowering directors to use defensive measures that they determine to be in the best interests of a corporation. We believe target boards should be able to take action to further the long-term (not just short-term) interests of the corporation, and to consider the interests of all of its stakeholders, not just short-term investors. It is time to allow Canadian boards of directors to use defensive measures, whether to obtain a better price for all shareholders in a sale of the corporation or to "just say no" to opportunistic bids that undervalue the corporation and prevent it and its stakeholders from realizing the benefits from its own long-term business strategies.

1. Current Policy Prevents Boards from Acting in the Best Interests of the Corporation

Current policy, as acknowledged by the CSA proposal and the AMF paper, suffers from several deficiencies.

First, NP 62-202 states that "take-over bid provisions should favour neither the offeror nor management of the target," but current policy favours bidders to the detriment of target corporations (and ultimately shareholders). Hostile bids almost invariably result in a sale of the target corporation on a timetable driven by the hostile bidder. This is a logical outcome of the CSA's view that the only legitimate purpose of any defensive measure implemented by a target board is to obtain a better bid.

The 45 to 60 day period before a rights plan is typically cease-traded provides, in many cases, little opportunity for the target board to obtain the highest price that might be available to shareholders, given the inability of many potential acquirers to make a competing bid in such a short period of time. The current scheme can therefore result in a "fire sale" of the target corporation at an undervalued price. Such circumstances do not allow the board to develop a robust auction with as many *bona fide* bidders as possible. The prospect of creating such an auction is hampered by the knowledge that any shareholder rights plan adopted by the board will be cease traded within a short period of time. The hostile bidder can often reduce or eliminate viable competition for ownership of the target corporation by taking advantage of its ability to control the process, for example by (i) launching a bid immediately prior to or during a holiday period or (ii) locking up shareholders prior to the formal announcement of a bid. Many shareholders, pressured by the limited timeframe and unable to determine with certainty whether a higher bid might emerge if more time was available, or whether or how quickly management's long-term business plans will bear fruit, will often sell their shares to arbitrageurs, hedge funds and other short-term traders in order to capture a certain gain, rather than risk losing an opportunity to sell at a premium. Arbitrageurs, who have less interest in a corporation's long-term prospects, will tender into any bid to ensure its completion. The hostile bidder, assisted by CSA policy, is able to set the rules of the game and is generally able to force the target board to quickly capitulate.

[1] The CSA proposal does not clearly distinguish between management (officers), who have authority to direct and control the day-to-day business of the corporation, and the directors, who have ultimate responsibility for the corporation and the power and obligation to supervise management. The potential conflicts of interest that arise with respect to management, and the mechanisms available under corporate law to manage those conflicts, are significantly different than those that apply to directors.

Second, current policy requires that a board be passive in the face of a hostile bid and generally prevents the board from taking most defensive actions that it reasonably determines, in the exercise of its fiduciary duties, to be in the best interests of the corporation. This means that the board has no real ability to protect the corporation from structurally or substantively coercive bids, and in particular from bids that substantially undervalue the corporation.[2] As discussed above, under the current scheme, the inevitable result of a hostile bid is the sale of the corporation, generally on an expedited basis. A target board has no real ability to prevent coercive and inadequate bids from being presented to shareholders in favour of pursuing management's long-term business plans.

Current policy also suffers from other deficiencies highlighted by the CSA, such as that it is not based on a policy review, has resulted in inconsistent and unpredictable decisions by securities regulators, and has given rise to clear policy "failures" where the target board was prevented from taking actions that either were clearly in the best interests of the corporation (*e.g.*, *Fibrek*) or were approved by shareholders (*e.g.*, *Lions Gate*).

2. The CSA Proposal Retains the Main Faults of Existing Policy

We acknowledge that the CSA proposal represents an improvement over current policy in some respects:

- The CSA proposal eliminates the costs to regulators and interested parties of bidders applying to regulators to cease trade rights plans.
- By allowing for up to 90 days before shareholders must vote on a board-adopted rights plan, the CSA proposal provides target boards with slightly more time to negotiate with the hostile bidder (as compared to the 45 to 60 day period prior to which the "pill must go" under current policy).
- There is an implicit requirement that a hostile bidder must acquire a meaningful equity position or receive significant support from other shareholders in order to requisition a shareholder meeting to vote down a plan or to make a proposal at an annual general meeting.

Notwithstanding these positive elements, the CSA proposal retains the main faults of current policy:

- The CSA proposal would continue to constrain the board's exercise of its fiduciary duties by imposing bright-line rules mandating conduct that may be inconsistent with directors' fiduciary duties to the corporation.[3]
- Canadian public corporations will continue to be "for sale" whenever an opportunistic bidder launches a bid (however coercive the bid is or undervalued the corporation is at the time).

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[2] A discussion of structural and substantive coercion and the threat posed by inadequate offers can be found in Sean Vanderpol and Edward Waitzer, "Mediating Rights and Responsibilities in Control Transactions" (2010) 48 Osgoode Hall L.J. 639 at 648 and 657–658.

[3] For a discussion of a board's fiduciary duties in the context of a change of control, see *BCE v. 1976 Debentureholders*, [2008] 3 S.C.R. 560 [*BCE*].

- Target boards will continue to lack the tools to effectively bargain for the highest price reasonably available in a sale of the corporate enterprise or, if deemed appropriate, to continue with management's long-term business plans.

By continuing current policy, albeit with the technical improvements noted above, the CSA proposal fails to address the fundamental inconsistency between the "management entrenchment" bias of securities regulatory authorities and the duties imposed by corporate law to manage the business and affairs of the corporation with a view to its *long-term interests*. This mandate, as described by the Supreme Court of Canada in *BCE*, is a "broad and contextual concept. It is not confined to short-term profit or share value. Where the corporation is an ongoing concern, it looks to the long-term interests of the corporation."[4] By preventing the board from fully exercising its fiduciary duties in the context of a change of control—a life or death moment for a corporation—CSA policy cripples the board just as its role as a steward of the best interests of the corporation becomes most important.

We discuss below the role and responsibility of the board of directors in the context of a change of control. However, we would like to note some of our concerns with specific aspects of the CSA proposal.

First, while there are certain benefits from bright-line rules such as those proposed by the CSA, bright-line rules can also create arbitrariness and unintended consequences. We are concerned that the CSA's proposed rules may influence the timing of hostile bids as bidders seek to use the rules to their advantage (*e.g.,* launching a bid during the first calendar quarter before the target corporation's annual general meeting). It would be a perverse outcome of regulatory policy if the CSA's rules result in some bids being timed to take advantage of the accidents of a regulatory calendar rather than underlying economic advantage.

Second, while the CSA proposal emphasizes the right of shareholders to respond to a bid, the CSA fails to respect the rights of shareholders under corporate law to bind the corporation and its shareholders in the future. The CSA should not limit the right of shareholders to adopt shareholder rights plans that are effective beyond a corporation's next annual general meeting. That the body of shareholders of a public corporation is constantly changing does not justify such limitations, and is inconsistent with the structure of corporate law, which allows current shareholders to bind future shareholders with respect to many fundamental matters in the life of a corporation. These fundamental matters include amalgamations, sales of substantially all assets of the corporation, the powers granted to the corporation upon incorporation, and similar matters. Shareholders expect such decisions to have long-term consequences, and other investors who dislike such consequences are free not to become shareholders. Consider the effect on corporate governance if shareholders were required to approve the corporation's bylaws every year, or to reconsider annually the corporate powers or share provisions in the articles. Management of the corporation by regular shareholder plebiscites would lead to unnecessary and unwelcome uncertainty and potentially arbitrary outcomes. Giving shareholders the power to make decisions that have long-lasting effects is more consistent with the basic structure of corporate law.

Third, while hostile bidders would no longer need to apply to securities commissions to cease trade rights plans, the CSA proposal does not necessarily eliminate the costs associated with

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[4] *Ibid.*, at para. 38.

these types of actions. Rather, such costs are likely to be shifted from the regulators to target corporations through an increase in proxy fights to remove rights plans, which will in turn create additional deal uncertainty.

3. The Role and Responsibilities of the Board of Directors in a Change of Control

Directors are obligated to act in the best interests of the corporation in connection with a change of control. Directors supervise management of the corporation and are responsible for controlling the potential conflicts that can arise between the interests of management and the interests of shareholders.

NP 62-202 highlights this potential conflict of interest, which is inherent in the separation of ownership and control of the corporation, and expresses concern regarding the possibility of management adopting defensive measures that could deny shareholders the ability to directly respond to a bid. NP 62-202 fails, however, to appreciate the duty of the board to resolve potential conflicts of interest between a corporation's executive officers and those of its shareholders, consistent with the directors' fiduciary duties. We must recognize that, in managing the business and affairs of the corporation, the board is instrumental in mitigating the potentially conflicting interests of management and shareholders. In other words, the board of directors is the antidote to the poison, not the source.

Moreover, the duty to act in the best interests of the corporation requires directors to consider the interests of all of the corporation's stakeholders, which may include the interests of shareholders and employees as well as other stakeholders. In many cases, the interests of the corporation and its shareholders, and different groups of shareholders, may be the same. But when the interests of the corporation and its shareholders diverge, or when the interests of particular groups of shareholders conflict with each other, the board must consider the interests of all shareholders. In such situations the board must avoid favouring the interests of particular shareholders over other shareholders and, in the words of the Supreme Court of Canada, must "treat individual stakeholders affected by corporate actions equitably and fairly." In contrast, individual shareholders do not have a duty to consider the interests of the corporation or other shareholders when taking action. It is therefore the responsibility of the board to consider the long-term interests of the corporation, as opposed to short-term profit or share value, and the interests of long-term investors, not just short-term traders. Under current and proposed CSA policy, directors cannot give full effect to their business judgment regarding what is in the long-term best interests of the corporation, and the interests of its various groups of shareholders, employees and other stakeholders.

Giving the target board the ability to "just say no" to a particular bid not only permits directors to comply with their fiduciary duties to the corporation, but respects the central role of directors in understanding, managing and developing the business, future plans and short- and long-term goals of the target corporation. Directors are obligated by law to act in the best interests of the corporation and to appropriately consider the interests of all of its stakeholders. Moreover, directors of Canadian public corporations are generally accomplished and dedicated individuals, hired for their expertise in business affairs, who take seriously their role in building better corporations and creating shareholder value. Directors who fall short of the high standards expected of them suffer not only professional harm, but the risks of litigation. These standards of conduct can be enforced directly by shareholders through Canada's courts.

Shareholders, by contrast, are entitled to act in their own individual interests, are not required to be concerned with its long-term prospects or the interests of other stakeholders, and often have less knowledge of a corporation's business than do its directors. On the other hand, shareholders collectively hold robust powers to police the conduct of directors. It is a fundamental right of shareholders to elect, and to remove, a corporation's directors. Shareholders may, individually or collectively, requisition a shareholder meeting to remove directors without cause. Proxy rules and corporate statutes substantially reduce the costs and burdens of making shareholder proposals, requisitioning meetings to remove directors and distributing dissident proxy circulars. Shareholders have the right to sue for breach of fiduciary duty or seek relief under the oppression remedy. Together these powers provide a powerful check on directorial authority and encourage respect for shareholder interests.

We also note that current TSX/TSXV policies include constraints on board actions, such as the requirement to elect all directors annually, on an individual basis, and the related prohibition against staggered boards. While we may dispute the desirability of some of these policies, they are the "price of admission" to a TSX or TSXV listing, and Canadian corporations can always choose to list their shares elsewhere.

4. General Comment Regarding the Policy Review Proposed by the AMF

While we support the broader policy review proposed by the AMF, we believe it should be even broader, and should more seriously consider revoking NP 62-202 and replacing it with a policy of non-interference with defensive tactics adopted by target boards, on the basis that aggrieved shareholders, either individually or as a class, can pursue claims for breach of fiduciary duties in court.

In our view, there is a much stronger case to be made for allowing defensive tactics and other board actions to be policed by shareholders through the ordinary avenues of corporate law. Our courts, by virtue of their role in society and the nature of the common law and civil procedure, are a better venue for considering whether a board has acted appropriately and complied with its fiduciary duties in connection with a takeover bid. It is through the courts that the law is developed and expounded—the decisions of courts of higher jurisdictions have precedential value and are followed by lower courts. Perhaps most importantly, only courts may opine on directors' fiduciary duties. In other words, directors must ultimately look to the courts, as interpreters of the law, to understand their legal obligations as fiduciaries. As they are not courts, Canada's securities regulatory authorities cannot provide reliable guidance to directors of Canada's public corporations regarding their duties to corporations; they can only enforce compliance with the laws, rules and regulations within the scope of their authority. As an example, the courts of Delaware—a small state which over many years has developed a specialized expertise in corporate law—decides cases involving Delaware corporations and their directors and officers, and in doing so provides guidance to corporations, directors, officers, lawyers, judges, academics and regulators throughout the world.

We would also recommend undertaking and studying empirical analyses of the impact of different policies regarding defensive tactics in other jurisdictions. For instance, our review of empirical studies suggests that differences in whether defensive measures are generally permitted (as in the United States) or not (as in the U.K. and Australia) lead to different substantive outcomes for shareholders. For example, it appears that there is more hostile activity in markets

that prohibit defensive measures[5] but that there are higher takeover premiums in the United States.[6] The data appear to support the view that shareholders ultimately benefit, in the form of higher takeover premiums, from a board's ability to employ takeover defenses.[7] The impact of particular defensive measures on the size of takeover premiums, the frequency of hostile offers and the liquidity of the market for corporate control, as well as the mediating effects, if any, of the composition of the market (*e.g.*, the prevalence of institutional investors) and other corporate governance rules (*e.g.*, the use of staggered boards and other "structural" defenses) on such variables, should be a crucial element of designing policy in this area. In considering the potential benefits of generally permitting defensive measures, it would be important to consider countervailing factors such as the costs imposed on market participants of a U.S.-style litigation model as compared to markets where regulatory policy make litigation uncommon (*e.g.*, the U.K., where deal-related litigation is practically non-existent).[8]

In summary, we believe a more wide-ranging discussion among capital markets participants and additional analysis is required before the CSA should adopt the CSA proposal, given the long-term effect such new policy is likely to have.

Please note that the following members of our Capital Markets and M&A Practice Group have participated in the preparation of this letter and may be contacted directly in the event you have any questions concerning our submissions:

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Yours very truly,

BENNETT JONES LLP

(signed) "Bennett Jones LLP"

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5 Tatyana Sololyk, "The effects of antitakeover provisions on acquisition targets" (2011) 17 J. Corp. Fin. 17 612.

6 Mark Gordon, "Takeover Defenses Work, Is That Such a Bad Thing?" (2002) 55 Stanford L. Rev. 819 at 824. See also the discussions of the Airgas/Air Products takeover battle in Vanderpol & Waitzer, supra note 2 at 642 and of the Willamette/Weyerhauser takeover battle in Martin Lipton, "Pills, Polls and Professors Redux" (2002) 69 Univ. of Chicago L. Rev. 1037 at 1057.

7 The recent Airgas/Air Products takeover battle is a demonstration of the virtues of the Delaware model. Delaware courts upheld the unanimous decisions of the Airgas board to "just say no" to a series of inadequate takeover bids by Air Products—decisions ultimately supported by three directors who were nominated by Air Products and elected to the Airgas board in a proxy battle. The price of Airgas stock rose significantly in the months after Air Products walked away from the transaction. Had Airgas been a Canadian issuer, its board could never have defended itself against Air Products inadequate bids and the shareholders would have approved a sale at a significantly lower share price. The Willamette/Weyerhauser takeover battle had a similar shareholder-favourable result, but in that case Weyerhauser eventually increased its bid to a price supported by the Willamette board. Willamette's shareholders would have approved a bid substantially lower than what their board was able to obtain.

8 See *e.g.* John Armour and David A. Skeel, Jr., "Who Writes the Rules for Hostile Takeovers, and Why?—The Peculiar Divergence of U.S. and U.K. Takeover Regulation" (2007) 95 Georgetown L.J. 1727 at