



UNIVERSITY OF TORONTO
FACULTY OF LAW

*84 Queen's Park
Toronto, Ontario M5S 2C5*

Anita Anand, B.A., B.A. (Juris), LL.B., LL.M.
Professor
E-mail: anita.anand@utoronto.ca
Direct Line: 416-946-4002
Facsimile: 416-978-7899

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The Secretary
Ontario Securities Commission
20 Queen Street West 22nd Floor,
Box 55 Toronto, Ontario
M5H 2S8
Email: comments@osc.gov.on.ca

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

Dear Sir/Madam:

I enclose my submission regarding the Proposed National Instrument relating to takeover bid law in Canada.

Thank you for your consideration.

Yours truly,

Anita Anand

Encl.

1. Introduction

When faced with an unwanted acquisition proposal, a target board may seek shareholder approval for a shareholder rights plan or “poison pill” to prevent acquisitions of its securities above the 20 percent legislative takeover bid threshold. The pill provides time for the target board to negotiate with the bidder for an enhanced bid, to solicit competing bids, or to propose some other alternative to its shareholders.¹ In the absence of a higher offer from the bidder and no alternatives coming forward, case law says that “the pill must go”² and the original bidder can proceed with its proposed acquisition transaction.³ But poison pills, even those ratified by shareholders, can remove the decision about whether a bid proceeds from the hands of shareholders, leaving it to rest with incumbent target management and the board who may not necessarily act in the shareholders’ best interests.

The Canadian Securities Administrators (CSA) recently proposed a new framework for the regulation of takeover bids.⁴ The framework contains the most significant reforms to the takeover bid regime in Canada in decades.⁵ Under the Proposal, takeover bids would have an irrevocable 50 percent minimum tender condition and would remain open for a minimum of 120 days.⁶ The 50 percent condition means that a bid would succeed only if a majority of independent shareholders tendered their securities in response to the bidder’s offer (securities of the bidder and its joint actors

¹ Marcel Kahan and Edward B Rock, “How I learned to Stop Worrying and Love the Pill” 69 (2002) University of Chicago Law Review 871.

² See *Re Royal Host Real Estate Investment Trust* (1999), 8 ASCS 3672, online: Alberta Securities Commission <[http://www.asc.ca/Notices%20Decisions%20Orders%20%20Rulings/Issuers/6974_Royal_Host_Real_Estate_Investment_Trust_\(The\)_-Reasons_-1999-11-24.pdf](http://www.asc.ca/Notices%20Decisions%20Orders%20%20Rulings/Issuers/6974_Royal_Host_Real_Estate_Investment_Trust_(The)_-Reasons_-1999-11-24.pdf)> [*Royal Host*].

³ Certain cases have evidenced an alternative regulatory approach, but they are the exception rather than the norm. See e.g. *Re Neo Materials Technologies Inc.*, 2009 LNONOSC 638, online: Ontario Securities Commission <https://www.osc.gov.on.ca/documents/en/Proceedings-RAD/rad_20090901_neo-material.pdf>; *Re Pulse Data Inc.*, 2007 ABASC 895, online: Alberta Securities Commission <http://albertasecurities.com/Notices%20Decisions%20Orders%20%20Rulings/Issuers/Pulse%20Data%20Inc_Nov30.pdf>.

⁴ CSA Notice And Request For Comment “Proposed Amendments To Multilateral Instrument 62-104 Take-Over Bids And Issuer Bids Proposed Changes To National Policy 62-203 Take-Over Bids And Issuer Bids And Proposed Consequential Amendments” online: http://www.osc.gov.on.ca/documents/en/Securities-Category6/csa_20150331_62-104_rfc-proposed-admendments-multilateral-instrument.pdf (March 31, 2015)[hereafter “50-10-120,” the “CSA Proposal” or the “Proposal”].

⁵ In terms of actual legislation, Canada’s takeover bid regime was introduced following the significant recommendations contained in the *Report of the Attorney General’s Committee on Securities Legislation in Ontario* (Toronto: Queen’s Printer, 1965) [*Kimber Report*]. For history see Condon et al, *Securities Law in Canada: Cases and Commentary*, 2d ed. (Toronto: Emond Montgomery, 2010).

⁶ CSA Proposal, *supra* note 4 at 2.

would not be counted in the 50 percent). Once the condition is met, the proposed rules would require an additional ten-day right to tender for undecided shareholders.

The CSA Proposal is a watershed moment in Canadian securities regulation: it contains important substantive amendments to the legislative regime and represents a united front for the provincial and territorial jurisdictions that comprise the CSA. The Proposal has been released for comment but even when the comment period closes, the CSA will be hard-pressed to amend the proposal in a material way given the difficulty in reaching the current compromise.⁷ Thus, the Proposal may well represent the takeover bid law that will apply across the country.

2. Poison Pills

Poison pills are a defensive tactic that enable the corporation to shield itself against hostile or unwelcome bidders. By adopting the pill, the target board deters potential acquirers from purchasing twenty percent (i.e. threshold which triggers the takeover bid rules) or more of the target's shares. The pill makes the acquisition expensive and is attractive for the board and management who may believe that a bid is not in the best interests of the corporation. They may wish to steer the corporation away from the bid and towards another transaction or approach for the corporation. In Canada, unlike in the U.S., the pill provides the board with flexibility to respond to the takeover bid rather than to eschew it altogether.

The target may adopt a poison pill prior to any hostile bid being launched or they may be asked to do so in the face of a bid (a so-called "tactical" pill). Once shareholders ratify the pill, the decision rests with the board regarding whether to trigger it, though, in reality, this rarely happens as the hostile bidder typically attempts to negotiate with the target or launches a proxy contest to replace the target board altogether. To be sure, if triggered, the poison pill would allow existing shareholders, except the bidder, to purchase shares at a discount so as to dilute the bidder's holdings

⁷ At one point in the process, the Autorité des Marchés Financiers and the Ontario Securities Commission were divided in their approaches to the issues. For the early AMF position, see *An Alternative Approach to Securities Regulators' Intervention in Defensive Tactics* (Autorité des Marchés Financiers, 2013), online: <http://www.lautorite.qc.ca/files/pdf/consultations/juin-2013/2013mars14-avis-amf-62-105-cons-publ-en.pdf> [AMF Report]. See also CSA Notice 62-306 "Update on Proposed National Instrument 62-105 Security Holder Rights Plans and AMF Consultation Paper "An Alternative Approach to Securities Regulators' Intervention in Defensive Tactics" http://www.osc.gov.on.ca/en/SecuritiesLaw_rule_20140911_62-306_update-holder-rights-plan.htm.

in the target.⁸ In this way, the pill (and by implication, the legal rules that permit the use of this defensive tactic) discriminates (or allows discrimination) as between the bidder *qua* shareholder and all other shareholders of the target. This discrimination runs contrary to the principle of equal treatment in securities regulation embodied in provisions such as the identical consideration provision (which ensures that all shareholders receive the same price for their shares).⁹

What then is the rationale for poison pills? These defensive tactics were meant to prevent hostile bidders from encouraging target shareholders to tender to an unreasonably low bid. In theory, the pill makes it prohibitively costly for the hostile bidder to obtain control of the target without the target board's cooperation.¹⁰ But the pill also places a wedge between the bidder and the target shareholders to whom it has made the offer. It puts management and the board in the driver's seat by increasing the cost of the bid and by forcing the bidder to negotiate with the board as opposed to the shareholders. The pill allows management and the board to bargain on behalf of shareholders, to seek out a higher or more attractive offer so that shareholders do not fall prey to the tactics of the hostile bidder.¹¹ Without a pill, a bidder could exploit coordination problems among widely disseminated shareholders and pay less for control than if the target were to face an auction.

But placing the bargaining power with the board and management gives rise to a concern that these parties may be conflicted.¹² As rational, self-interested actors, directors may well act in their own best interests rather than in the corporation's, regardless of their ongoing fiduciary duty.¹³ In the face of a hostile takeover bid where they may lose their positions following a change of control,

⁸ This is known as a "flip-in" provision (the most common type) which typically states that upon the acquisition of a certain percentage (10 or 20 percent) of the target's outstanding securities, each right other than those held by the bidder entitles its holder upon payment to acquire the target's securities having a market value equal to some multiple (e.g. two times) of the exercise price. See "Poison Pill", online: Macabacus <<https://www.macabacus.com/defense/poison-pill>>.

⁹ OSA, s 97(1) and s 97.2(1). On the concept of equality in securities regulation, see Anita Anand, "Regulating Issuer Bids: The Case of the Dutch Auction" (2000) 45 McGill LJ 133. See also Jeffrey MacIntosh, "Poison Pills in Canada: A Reply to Dey and Yalden" in (1991) 17 CBLJ 323 at 334 [*A Reply to Dey and Yalden*], written in reply to Peter Dey and Robert Yalden, "Keeping the Playing Field Level: Poison Pills and Directors' Fiduciary Duties in Canadian Take-Over Law" (1991) 17 CBLJ 252.

¹⁰ Jeffrey G MacIntosh, "The Poison Pill; A Noxious Nostrum for Canadian Shareholders" (1989) 15 CBLJ 276 [*Nostrum*].

¹¹ MacIntosh, *Nostrum ibid.* at 278-279. See also Jeffrey MacIntosh, *A Reply to Dey and Yalden*, *supra* note 8.

¹² Kimber Report *supra* note 5; *347883 Alberta Ltd v Producers Pipelines Ltd* (1991), 80 DLR (4th) 359 (Sask CA) [*Producers Pipelines*].

¹³ As Jensen and Meckling explain, if both parties to an agency relationship "are utility maximizers, there is good reason to believe that the agent will not always act in the best interests of the principal." Michael C Jensen & William H Meckling, "Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure" (1976) 3 *Journal of Financial Economics* 305 at 309.

management and the board may make efforts to perpetuate themselves in office.¹⁴ They may simply seek to retain their current position or even to “extract higher wages and larger perquisites from shareholders, and obtain more latitude in determining corporate strategy.”¹⁵

The concern with management entrenchment provides the historic rationale of Canadian takeover bid law.¹⁶ Yet, some question the validity of the so-called “management entrenchment hypothesis.” First, one cannot determine with certainty that directors and management seek to entrench themselves in any given situation. Second, the theory ignores senior managers’ and directors’ attempts to fulfill their fiduciary duties. The OSC has recognized that target boards of directors genuinely attempt to fulfill their fiduciary duties to the corporation, holding that a measure of deference should be accorded to board decisions.¹⁷ However, the question is not whether managers and the board *will* put their own interests ahead of the corporation and its stakeholders but rather whether they *may* do so. As long as management and the board have the opportunity to prioritize their own interests above the corporation’s, management entrenchment retains relevancy.

Why not then strip senior management and the board of their powers outside of the takeover context and let shareholders make all major decisions? As discussed above, takeover contests are not the ordinary course of business. Given that there is a change of control on the immediate horizon, takeovers intensify the threat of management entrenchment as directors and senior managers contemplate a potential loss of board seats and/or employment. Thus the applicable legal regime must minimize the impact of potential conflicts of interest at the board and senior management level.

The legislative rationale for poison pills in Canada is set forth in National Policy 62-202, which articulates two underlying principles regarding a board’s implementation of takeover defences. First, unrestricted auctions produce the most desirable results in takeover situations. Second, shareholders of the target should generally be given an opportunity to determine the ultimate outcome of the hostile bid by making a fully informed decision.¹⁸ As a consequence of these

¹⁴ See *Producers Pipelines*, *supra* note 12 and *MacIntosh Nostrum* *supra* note 10. In the era of high executive compensation, the MEH continues to have force and relevance.

¹⁵ Andrei Shleifer & Robert W Vishny, “Management Entrenchment: The Case of Manager-Specific Investments” (1989) 25 *Journal of Financial Economics* 123.

¹⁶ Kimber Report, *supra* note 5 and *Producers Pipelines*, *supra* note 12.

¹⁷ *Neo Materials Technologies Inc.*, *supra* note 3 at 91, 103.

¹⁸ *National Policy 62-202, Take-Over Bids: Defensive Tactics [NP 62-202]*.

principles, Canadian securities commissions have historically allowed target boards to use defensive tactics solely to attempt to obtain a better bid, rather than to reject a bid outright.

This may sound straightforward but it's not. Poison pill cases turn on the specific facts of the case and these facts always differ.¹⁹ Securities commissions, which are administrative bodies that are not required to adhere to a system of precedent, have held that a number of factors must be considered in making the determination of whether a defensive tactic can remain in place, including whether the bid is coercive or unfair to target shareholders; when the pill was adopted; whether the board obtained shareholder approval of the pill; and the status of any auction process being conducted by the target in order to source a higher offer.²⁰ The case-specific approach has injected unwelcome uncertainty into the market.²¹ This uncertainty potentially hampers bids, since market participants cannot know *ex ante* what rules will apply to their bid, whether the bid will be permitted to proceed, or what the corresponding timeframe will be. Arguably, decisions about takeover bids should not rest only with the board or with the regulator, but with those who are most affected by the transaction: the target shareholders.

Now one could argue that uncertainty is not necessarily disadvantageous to the target shareholders if it results from a period during which the board is exploring alternatives. While this argument has merit, it does not take into account the potential for management and the board to search for alternatives that are more self-serving than the original offer. The lengthier the bid period, the more leeway for the board to delay or forgo decisions that may be in the shareholders' best interests.

3. Reform of Takeover Bid Regime?

In light of the uncertainty emanating from the case law, the question persists as to whether reform of Canada's takeover bid law regime, including as contemplated in the CSA Proposal, is warranted. The CSA Proposal, dubbed "50-10-120," seeks to strike a certain balance between the interests of

¹⁹ See *Re Royal Host Real Estate Investment Trust* (1999), 8 ASCS 3672, online: Alberta Securities Commission <[http://www.asc.ca/Notices%20Decisions%20Orders%20%20Rulings/Issuers/6974_Royal_Host_Real_Estate_Investment_Trust_\(The\)_-_Reasons_-_1999-11-24.pdf](http://www.asc.ca/Notices%20Decisions%20Orders%20%20Rulings/Issuers/6974_Royal_Host_Real_Estate_Investment_Trust_(The)_-_Reasons_-_1999-11-24.pdf)> [*Royal Host*].

¹⁹ See *Re Baffinland Iron Mines Corp*, 2010 LNONOSC 904; *Lions Gate Entertainment Corp*, 2010 BCSECCOM 432.

²⁰ See *HudBay Minerals Inc and Augusta Resource Corporation*, (Re) 2014 BCSECCOM 153 [*Hudbay*].

²¹ See *Re Neo Materials Technologies Inc.*, 2009 LNONOSC 638, online: Ontario Securities Commission <https://www.osc.gov.on.ca/documents/en/Proceedings-RAD/rad_20090901_neo-material.pdf>; *Re Pulse Data Inc.*, 2007 ABASC 895, online: Alberta Securities Commission <http://albertasecurities.com/Notices%20Decisions%20Orders%20%20Rulings/Issuers/Pulse%20Data%20Inc_Nov30.pdf>.

target shareholders and the target board. Under the Proposal, bids would be subject to a mandatory (i.e. unwaivable) minimum tender condition of more than 50 percent of all outstanding target securities, excluding those held by the bidder and its joint actors. Bids would therefore only succeed with the support of a majority of independent shareholders.

The 50-percent minimum tender condition is consistent with the arguments above as it weighs in favour of shareholder decision-making. The underlying rationale is that in a hostile bid, “each shareholder must ultimately be given access to an offer and the opportunity to tender.”²² Akin to a shareholder vote, this approach allows majority shareholders the ability to determine whether the takeover bid will succeed. Minority shareholders who wish to tender but whose views deviate from the majority who do not tender, will not have their shares taken up pursuant to the bid. In an era where shareholders are increasingly sophisticated,²³ it makes sense to allow bidders to “speak to” target shareholders directly – especially in the case of poison pills that are not approved by shareholders.

The minimum tender condition will prevent bidders from being able to corner target shareholders into the undesirable choice of selling into an underpriced offer or being stuck with illiquid shares.²⁴ While this aspect of the CSA Proposal is laudable, the 120-day bid period is ill-conceived. Hostile bidders will likely feel exposed under the 120-day period since their bid for remains open and a white knight can come forward during this time.²⁵ Further, financing will likely be more expensive and more risky. Financial resources that bidders have allocated to purchase the target’s shares remain in limbo (i.e. unusable) while the 120-day clock ticks.

The 120-day bid period will, as a result, deter bids and certainly hostile bids from occurring, which is optimal from neither an economic efficiency nor an investor protection standpoint. It is true that the target board can reduce the 120-day period as it might in a friendly transaction. If it does, the bid must remain open for a minimum of 35 days and all bids would

²² See James C Tory et al, “Canadian securities regulators’ decisions on poison pills diverge” (30 July 2010), online: Torys <www.torys.com>.

²³ See Jeffrey Macintosh, “The Role of Institutional and Retail Investors in Canadian Capital Markets” 31:2 Osgoode Hall Law Journal 372.

²⁴ See Anita Anand, “New Canadian Securities Administrators’ Rules would discourage takeover bids,” *The National Post* (April 1, 2015).

²⁵ See MacIntosh states in *A Reply to Dey and Yalden*, *supra* note 9 at 332.

be subject to the same period.²⁶ But the argument here is that 35 days should be the ceiling, not the floor, in terms of the time during which the target board has to act. The justification for such a lengthy bid period, including the negative implications for target shareholders, bidders and takeover bids generally, has not been made in the CSA Proposal.

If implemented, the CSA Proposal means that specific requirements relating to majority approval and bid periods will govern takeover bids. The law relating to takeover bids will, therefore be more certain and will lead to less poison pill litigation. In this way, the CSA Proposal is, generally, an improvement on the law that it would leave behind. But it could be the case that instead of relying on poison pills, target boards will then implement other defensive tactics (asset sales or private placements, for example) as they will have a lengthy period of 120 days in which to do so. It seems plausible that regulatory intervention may occur as a result of tactics *other than* poison pills. Furthermore, nothing seems to prohibit target boards from implementing tactical pills prior to the expiry of the 120-day bid period. With no national securities regulator in place, it is possible that individual jurisdictions will address tactical pills differently and the fragmentation that has plagued the takeover bid regime in the past will continue.

4. Conclusion

Poison pills adopted without shareholder approval remove decisions about a hostile bid from shareholders, allowing them to rest with the target board. As long as agency costs in the takeover bid context exist, shareholders should be able to decide the fate of their investment. A 120-day bid period during which the bid can remain open disadvantages both target shareholders and bidders and would ultimately deter bids from occurring. It is counterintuitive for takeover bid rules to have the effect of discouraging bids; surely a solution, which better attends to shareholder interests, can be found.

²⁶ CSA Proposal, *supra* note 4 at section 2.28.