

MARCH 31, 2015

50-10-120: A New Code for Hostile Bids

Canadian Securities Regulators Publish Proposed Amendments to Take-Over Bid Rules

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Please note: An updated and more comprehensive discussion of this topic is available in *Canadian Securities Regulators Chart New Course for Regulation of Hostile Take-over Bids*.

The Canadian Securities Administrators (CSA) published today for comment proposed rules to implement previously announced changes to the Canadian take-over bid regime. These rules will significantly change the way that hostile take-over bids are conducted in Canada.

Since the announcement in September 2014 of the broad strokes of the changes, the changes have been colloquially known as the “50-10-120 amendments” after the following three new requirements that would be introduced to the take-over bid regime:

- **50% Mandatory Minimum Tender Condition:** Bids must be subject to a mandatory tender condition requiring more than 50% of target securities held by persons other than the bidder to be tendered before the bidder can take up any securities under the bid.
- **10 Day Extension:** Once the minimum tender condition and other bid conditions have been met, bids would have to be extended for an additional 10 days to permit undecided shareholders to accept the bid.
- **120 Day Bid Period:** Bids would have to remain open for a minimum of 120 days unless either (i) the target board announces that it is reducing the bid period to a shorter period of at least 35 days, in which case the shorter period would apply to all contemporaneous bids; or (ii) the target announces a friendly transaction, in which case the minimum deposit period for all contemporaneous bids would be automatically reduced to 35 days.

With the proposed amendments, the CSA’s objective is to enhance the quality and integrity of the take-over bid regime and rebalance the current dynamics between hostile bidders and target boards by “(i) facilitating the ability of shareholders to make voluntary, informed and co-ordinated tender decisions, and (ii) providing target boards with additional time to respond to hostile bids.”

More Time and More Leverage for Target Boards

The CSA’s rebalancing efforts will make bids materially more challenging for hostile bidders. Under current rules and practice, the minimum bid period is 35 days and any shareholder rights plan (or “poison pill”) that the target might adopt to fend off a hostile bidder is routinely dismantled by securities regulators within 45-70 days of bid commencement.

The new 120-day period gives target boards a significantly longer period of time to evaluate a bid, seek value enhancing alternatives or to make the case for rejection of a bid. It also provides a greater degree of predictability for a target board and its advisors to establish a strategic process, providing a fixed period of time as opposed to the variable and shorter durations that securities commissions have allowed poison pills to last. Because the CSA has stated that it does not propose to change its defensive tactics policy applicable to poison pills, it is possible that a target company could seek to use a shareholder rights plan to obtain additional time beyond 120 days to generate other options. However, we expect that, except perhaps in extraordinary circumstances, securities commissions would swiftly

dismantle rights plans that interfere with the ability of shareholders to tender to a bid that has been outstanding for 120 days and which complies with the other elements of the proposed new rules.

By giving target boards control over the ability to shorten the 120-day bid period, the new rules will give interested bidders a greater incentive to negotiate with target boards rather than taking their offer directly to shareholders. A short bid period is typically key to limiting interloper risk. Under the new rules, bidders will have to bargain with the target in order to get that benefit, giving target boards the opportunity to negotiate for more value in return.

Power to the Collective

Next to the lengthening of the bid period, the most significant impact of the new rules will be to facilitate collective shareholder decision making in response to a bid.

The requirement for a 50% minimum tender condition in every bid will mean that shareholders willing to sell to a bidder may be prevented from doing so if the bid is not supported by a majority of the target shareholders. In the past, hostile bidders would typically reserve the right to waive their own self-imposed minimum tender condition. This has meant that even where a bidder is unsuccessful in achieving a targeted majority of shares, it might seize the opportunity to become a significant minority shareholder (e.g. 40% owner) by waiving its minimum tender condition and thus achieve a blocking position over future change of control transactions. This tactic was employed in Carl Icahn's hostile bid for Lions Gate Entertainment where Icahn waived his minimum tender condition in order to acquire 13.2% of the outstanding shares, giving him a 31% ownership block which he subsequently increased to 37%. Under the proposed new rules, Icahn would have been prevented from acquiring any shares under his bid as a majority of Lions Gate shareholders had declined to tender.

The rule changes will also make partial bids more difficult. Even where a bidder is not seeking to acquire majority ownership of the target, the 50% minimum tender condition will apply meaning that a majority of shareholders would have to be willing to sell a portion of their shares to the bidder.

The CSA expects that the requirement of a 50% minimum tender condition coupled with the new requirement for a 10 day extension of successful bids will also "ensure the legitimacy of individual security holder tender decisions" by eliminating the "pressure to tender" that has been noted of bids that are not subject to such restrictions.

A Success for Harmonization

The proposed amendments are the culmination of 24 months of consultation by Canadian securities regulators following the publication in March 2013 of two different defensive tactics policy proposals by the CSA and Québec's Autorité des marchés financiers (AMF). While those proposals presented divergent approaches to the regulation of defensive tactics, the proposed amendments represent a compromise in favour of harmonization and a common approach across Canada in dealing with the regulation of take-over bids with elements of each proposal making their way into the proposed amendments.

Still a Role for Rights Plans, but More Limited

In today's notice of the proposed rule changes, the CSA has reiterated that it is not currently contemplating any changes to the CSA's existing policy on defensive tactics. Despite this, we expect that the use of shareholder rights plans to restrict hostile bids where the new bid requirements are satisfied will, except in extraordinary circumstances, be met by swift intervention from securities regulators.

Outside of the context of hostile bids, rights plans will continue to be relevant to restrict shareholders from accumulating large positions through transactions that are exempt from the take-over bid rules. Consequently, boards wary of shareholders making "creeping" acquisitions of control through the private agreement purchase exemption and other take-over bid exemptions will still find utility in shareholders rights plans.

The CSA has requested that comments on the proposed rules be submitted by June 29, 2015.

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