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Between a Block and a Hard Place: ESW Capital Denied Relief in Proposed Bid for Optiva

Authors: Patricia L. Olasker and Jordan Lavi

In the recently released reasons of the Ontario Securities Commission (OSC) in *Re ESW Capital, LLC*, the OSC reconfirmed the proposition, first expressed in *Re Aurora Cannabis Inc.*, that barring exceptional circumstances or abusive or improper conduct that undermines shareholder choice, predictability of the recently recalibrated takeover bid regime will be the prevailing consideration.

Background

Since January 2020, ESW Capital, LLC, had been engaged in a public dispute with Maple Rock Capital Partners Inc. and EdgePoint Investment Group Inc. regarding the governance, operations and strategic direction of TSX-listed issuer Optiva Inc. Collectively, the three shareholders held more than two-thirds of Optiva's outstanding subordinate voting shares, with ESW holding approximately 28%, Maple Rock holding approximately 22.4% and EdgePoint holding approximately 18.1%. The dispute manifested in multiple forums, including a proxy contest launched by Maple Rock, court proceedings commenced by ESW regarding a debenture financing and preferred share redemption, and a proposed takeover bid by ESW.

In July 2020, ESW announced its intention to make an offer to acquire all of Optiva's outstanding shares for $60 per share in cash, which represented a 122% premium to the 20-day VWAP, conditional upon it obtaining exemptive relief from the 50% minimum tender requirement. On the same day, EdgePoint announced that it did not intend to tender its shares and that it had no interest in pursuing discussions with ESW regarding a potential transaction. Maple Rock made a similar announcement the following day. Optiva also adopted a tactical shareholder rights plan that would prevent the bid from proceeding absent a waiver by Optiva's board. The rights plan was subsequently approved by a 51.87% vote of Optiva's shareholders.

The "New" Bid Regime

In 2016, the Canadian Securities Administrators (CSA) fundamentally changed the takeover bid regime by (i) requiring that more than 50% of the outstanding securities of the class subject to a bid that are not held by the bidder or its joint actors be deposited to the bid and not withdrawn (Minimum Tender Requirement); (ii) implementing a mandatory 10-day extension period following satisfaction of the bid conditions, including the Minimum Tender Requirement; and (iii) imposing a 105-day minimum deposit period for a bid. The amendments were designed to rebalance the dynamics among bidders, target companies and securityholders, including by facilitating collective tendering decisions. The CSA's stated purpose for adopting the Minimum Tender Requirement was to ensure that an acquisition of control through a takeover bid be achieved in a manner akin to a vote on the bid. The CSA recognized the potential enhanced leverage that the Minimum Tender Requirement afforded to control block holders and determined that this could be adequately addressed through exemptive relief, but declined to provide guidance on the circumstances in which relief may be warranted.

Because ESW already held approximately 28% of the outstanding shares, more than half of the remaining shares not held by ESW (approximately 36%) would have to be tendered to its bid in order for it to satisfy the Minimum Tender Requirement. This would be mathematically impossible if both Maple Rock and EdgePoint refused to tender, given that their combined interests exceeded 40% of the outstanding shares. Accordingly, ESW applied to the OSC for exemptive relief that would allow it to exclude the shares held by Maple Rock and EdgePoint for the purposes of determining whether the Minimum Tender Requirement would be satisfied.

The OSC's Framework for Relief

In its reasons, the OSC emphasized the importance of maintaining a predictable bid framework that provides market participants with certainty regarding the way the regime operates. The OSC concluded that it should not intervene absent exceptional circumstances or clear improper or abusive conduct by the target, bidder or control block holders that would undermine minority shareholder choice. In evaluating whether it would be in the public interest to grant relief, the OSC provided a non-exhaustive list of factors that may be relevant, including the following:

- the nature and circumstances of the bid;
- the control dynamics of the target (both pre-existing control dynamics and any changes to the control dynamics);
- the impact of a grant or denial of exemptive relief on shareholders;
- the conduct of the control block holders and any special or differing interests or stake in the outcome of the bid;
- the conduct of the target and its board;
- the conduct of the bidder; and
- any other information indicating the views of the target shareholders with respect to the bid.

No Basis for Relief in the Circumstances

Following its assessment of the factors, the OSC concluded that there were neither exceptional circumstances nor abusive or improper conduct that warranted relief from the Minimum Tender Requirement:

- The OSC emphasized the fact that Optiva's control dynamics had been static. All three block holders had accumulated their positions well in advance of ESW's proposed bid and the control dynamics at Optiva were evident to the minority shareholders. Importantly, in the OSC's view, there was no "tactical share issuance or any accumulation, dilution or other alteration of shareholder control in anticipation of, or during, a bid." Accordingly, the facts did not engage the abuse issues present in *Re Hecla Mining Company* and *Re Red Eagle*.
- The OSC also noted the amended bid regime recognized that enhanced leverage for control block holders could result in bids not being made at all or shareholders being deprived of the ability to respond to a bid. "The nature of the leverage held by Maple Rock and EdgePoint as a result of their shareholdings was explicitly contemplated as part of the amendments to the bid regime."
- The OSC was unconcerned by the fact that both Maple Rock and EdgePoint had announced their respective intentions not to tender to the bid. The OSC explicitly stated that all shareholders are entitled to decide their own interests and the price at which they are willing to exit, and that transparency of shareholders' views regarding a bid may enhance shareholder choice and contribute to improved overall bid quality.
- The OSC was not convinced that relief would positively affect shareholder choice. Notwithstanding that the proposed bid price represented a significant premium, relief from the Minimum Tender Requirement could result in shareholders feeling pressured to tender to avoid retaining an interest in an even more illiquid company for which control had been further consolidated. This risk, in the OSC's judgment, outweighed the risk that denying the exemptive relief would unfairly limit shareholders' ability to tender.
- Finally, in evaluating the conduct of each of ESW, Maple Rock, EdgePoint and Optiva, the OSC concluded that none of them had acted in a manner that could be construed as abusive or improper. Although Maple Rock and EdgePoint were aligned in their objectives, the OSC confirmed that control block holders may engage in coordinated efforts in order to pursue their own financial interests as investors. None of their actions amounted to a shared objective or concerted effort to impede ESW's bid or to control or influence Optiva's board or special committee in its response to the bid; nor was there evidence of any "conflicting or special interest."

The OSC examined the conduct of Optiva, its board and special committee and gave it a (barely) passing grade.

- In addressing the concern that the only two members of the special committee charged with evaluating ESW's proposed bid were both nominees of Maple Rock (one of the shareholders opposing the bid), the OSC noted that there was no basis to conclude that they did not act in accordance with their duties, that they were motivated to impede the bid or that they were improperly influenced by Maple Rock or EdgePoint in the performance of their duties. Presumably, had there been some evidence of influence or improper motivation, this important governance consideration might have weighed more heavily.
- Reading between the lines, the OSC was critical of the tactical rights plan adopted by the special committee in the face of the bid. The OSC noted that there was no evidence that the committee explored strategic alternatives or commenced an auction process, which was presumably what the rights plan was intended to facilitate. However, the fact that ESW did not challenge the rights plan as an improper defensive tactic precluded the full consideration of the issue.
- Finally, although the OSC noted that Optiva's special committee's initial efforts "could fairly be described as being tactical" and acknowledged that Optiva had taken steps to reduce ESW's control and influence, it did not engage in conduct that rose to the level of abuse and did not unfairly or improperly impede ESW's bid.

Key Takeaways

- **Block holders can generally "just say no" to a bid.** An exemption from the Minimum Tender Requirement will require exceptional circumstances or abusive or improper conduct that undermines minority shareholder choice. Absent such circumstances or problematic conduct, the OSC's decision clarifies that it will not intervene to negate the potential veto power of a block holder that refuses to tender to a bid even if doing so makes it impossible for the bid to succeed.
- **Obtaining relief will be difficult but not impossible.** Given the paramountcy of predictability in the application of the recalibrated bid regime, it will be no easy task to get an exemption from the bid rules. However, the decision signals where that might be possible. For example, a block holder's shares may well have been excluded from the Minimum Tender Requirement if:
  - it had taken steps to influence the target's board or special committee;
  - it had some conflicting or special interest that created misalignment between it and the other minority shareholders; or
  - there had been a tactical share issuance or accumulation, dilution or alteration of shareholder control in anticipation of a bid.
- ***Hecla* still governs issuances of securities in response to a bid.** The reasons do not detract from the decision of the OSC and the British Columbia Securities Commission in *Hecla*, which sets out the test for determining whether an issuance of securities in response to, or in anticipation of, a bid is permissible. Although the applicant in *Hecla* declined to do so, the commissions noted that a party could request relief that would allow it to exclude securities issued in tactical private placement for the purposes of the Minimum Tender Requirement. Although the implication in *Hecla* was that only the newly issued securities would be excluded, further abusive or improper conduct by a block holder could conceivably result in the block holder's entire interest being excluded.
- **Future applications will likely require a full hearing.** Exemptive relief is typically considered and granted by staff rather than by a panel of commissioners. However, given that bidders and block holders will be adverse in interest and that the OSC's decision does not provide a clear road map indicating when relief will be justified, we expect that future applications on this issue may also need to be considered in the context of a full hearing. This will make such applications more complex, expensive and time-consuming for all parties involved, and could serve to dissuade bidders from pursuing a bid in similar circumstances.

Key Contacts: Patricia L. Olasker and Melanie A. Shishler

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