When “No” Means “Maybe” — the State of the “Just Say No" Defence in Canada

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Unsolicited (or hostile) take-over bids historically have been easier and less time-consuming to accomplish in Canada than in the United States[1] because there are fewer structural and other take-over defences available in Canada. The most notable distinction between the US and Canada is the ability of US targets to rely on the "just say no" defence in fending off an undesired hostile bid. As a general rule, it has not been possible for Canadian companies to rely indefinitely on take-over defences to address a hostile bid. While US courts have shown considerable deference to the business judgment of a target board in the face of a hostile bid, the view in Canada traditionally has been that at some point, shareholders must be given the opportunity to exercise the right to make a choice regarding the sale of their shares.

In the last several years, however, there has been increasing discussion about whether the Canadian position is still appropriate in an era of increased shareholder activism and improved governance practices. In June 2008, for example, the Competition Policy Review Panel (a panel mandated by the Canadian Government to review Canada's competition and foreign investment policies, and recommend ways to improve Canada's productivity and competitiveness) released a report entitled *Compete to Win* in which it suggested that the Canadian position was outdated and recommended, among other things, that Canada update its regulatory framework "to place directors of Canadian companies on the same footing as their counterparts at Delaware companies".

Two relatively recent shareholder rights plan decisions – one by each of the Alberta Securities Commission (ASC) and the Ontario Securities Commission (OSC) – appear to have taken a step towards allowing boards of Canadian companies that are the target of unsolicited take-over bids to use a take-over defence to thwart (or "just say no" to) an unwanted hostile bid. However, not long after the OSC decision, an inconsistent British Columbia Securities Commission (BCSC) decision again put the status of the "just say no" defence in Canada into question, indicating a divergence in the positions of securities regulators on the use of shareholder rights plans.

In a rights plan decision released in December 2010, the OSC took the opportunity to clarify aspects of its approach to the use of shareholder rights plans in the face of an unsolicited take-over bid. In this most recent decision, the OSC signaled a clear limit on its willingness to defer to a target board's business judgment in determining whether shareholders should be prevented by a rights plan from tendering to an undesirable take-over bid. However, the central discrepancy created by the divergent approaches taken by the securities regulators in Ontario and Alberta, on the one hand, and British Columbia, on the other hand, regarding the impact of strong shareholder support for a rights plan given in the face of a hostile bid remains unresolved.

Below we review the scope of the "just say no" defence in the United States and discuss its applicability in Canada given the recent securities commission decisions. We then consider the practical implications of these decisions for Canadian companies facing an unwelcome take-over bid.

THE ABILITY OF US COMPANIES TO "JUST SAY NO"

In the United States, courts generally defer to the business judgment of directors and afford them considerable latitude in the adoption of take-over defences in the face of unsolicited take-over bids. US courts typically have held that directors of target companies have

properly satisfied their fiduciary duties if (i) they are not acting in their own self-interest, (ii) they have reasonable grounds for believing that a particular threat to the corporation exists, (iii) they adopt reasonable measures to address the threat posed, and (iv) they act diligently on the basis of expert independent advice and full and complete information. Even in circumstances where bids are not deemed coercive, US courts have ruled that directors may mount a valid defence if the bid conflicts with a previously announced and well developed long-range business plan. It follows that in the United States, boards of directors are entitled to "just say no" to a bid or proposed bid and to use defensive tactics to prevent (as opposed to simply delay) a bid. It is only once a company has been put "in play" and it becomes apparent that the company will be sold or broken up that the board's duty shifts exclusively to enhancing shareholder value, either by negotiating better bid terms or by seeking and proposing an alternative transaction (such as a competing bid).

One of the critical components of the US-style "just say no" defence relies on the ability of a target to implement and uphold a shareholder rights plan (also known as a "poison pill"). Under a shareholder rights plan, a company issues rights to its shareholders which entitle them to acquire additional shares of the company at a deeply discounted price if any bidder purchases more than a prescribed interest in the company (usually 15 to 20 per cent). The rights under the plan are not exercisable by the bidder, with the consequence that the bidder's shares would be significantly diluted if the rights plan is triggered, rendering take up under a take-over bid prohibitively expensive.

Because courts in the US are loath to overrule a proper exercise of directors' business judgment and the US Securities and Exchange Commission will not intervene to terminate a target's shareholder rights plan, the most practical avenue for a hostile bidder faced with such a plan is to launch a proxy contest with a view to replacing the target's board of directors so that the reconfigured board can render the rights plan inoperative. In the US, this can be a time consuming proposition that can last well over a year, particularly if the target company has a staggered board of directors in which only one third of the board is elected at each annual meeting. By contrast, staggered board provisions do not have utility in Canada, as the *Canada Business Corporations Act* and other Canadian corporate statutes allow shareholders of a company to remove directors at any time by ordinary resolution. Accordingly, shareholders in Canada holding in aggregate five per cent of the outstanding shares of a company can requisition a meeting of shareholders at any time and seek to replace the entire board.

The "just say no" defence was recently implemented by Iowa-based convenience store chain Casey's General Stores Inc. in the face of an unsolicited bid from Québec-based Alimentation Couche Tard Inc. Shortly after the bid was announced in April 2010, Casey's adopted a shareholder rights plan and rejected the Couche Tard offer, asserting that it undervalued the company and that Casey's would be better served growing on its own. In the ensuing months, Couche Tard increased its initial US$36 per share bid twice, first to US$36.75 per share on July 22, 2010, and then again to US$38.50 per share on September 1, 2010. On September 9, 2010, Casey's reported that it had received an indicative proposal from 7-Eleven at US$40. While Casey's board of directors continued to take the position that even the US$40 proposal undervalued the company's shares, it nonetheless authorized discussions with 7-Eleven. Because efforts by Couche Tard to replace Casey's incumbent board at Casey's annual general meeting on September 23, 2010, were unsuccessful, the ability of Casey's to "just say no" left Couche Tard with little option but to terminate its proposed acquisition or come up with a higher bid that would garner the support of Casey's board. On September 30, 2010, Couche Tard abandoned its bid for Casey's, citing the refusal of Casey's board to negotiate.

SHAREHOLDER RIGHTS PLANS AND THE "JUST SAY NO" DEFENCE IN CANADA

For many years, Canada has operated under a significantly more bidder-friendly take-over bid regime. In fact, many commentators regard the Canadian rules as amongst the most bidder-friendly in the world.

As arbiters of whether a Canadian company can rely on a shareholder rights plan to stave off an unsolicited take-over bid, Canadian securities commissions historically have taken the approach that a company cannot rely on a rights plan to "just say no" and thereby prevent shares from being purchased by a hostile bidder. While a rights plan can legitimately be implemented in order to give a target company time to conduct an auction and identify alternatives to an unsolicited bid, for many years the general principle has been that at some point the pill "must go" and shareholders must be given the opportunity to tender to the offer made by the unsolicited bidder if they choose to do so. In contrast to the jurisprudence emanating from US courts which allows the board of a company to "just say no" if it can show that it has been acting in good faith and that its response is reasonable relative to the threat posed, Canadian securities regulators historically have refused to accept the proposition that the board of a target company can decide whether the unsolicited bid is in the best interests of the company and its shareholders and then use a poison pill to block the bid.

As a result, when faced with an application by a hostile bidder to cease trade a rights plan, the Canadian securities commissions typically have framed the issue to be dealt with not as "if", but rather "when", the pill must go. In undertaking this assessment, the Canadian securities commissions have articulated a series of factors to be considered, including whether shareholder approval of the rights plan was obtained, when the plan was adopted, whether there is broad shareholder support for the continued operation of the rights plan, the nature of the bid, including whether it is coercive or unfair to target shareholders, and the status of any auction process being conducted by the target in order to source a higher offer.

Weighing these and other relevant factors, the securities commissions have over the years determined the date on which the

pill "must go" for different kinds of bids, including partial bids and insider bids, and in different types of scenarios, including tactical pills and conventional shareholder-approved pills. Generally, the commissions will cease trade the pill somewhere in the range of 45 to 70 days after the start of the unsolicited bid. However, in two relatively recent decisions, the securities commissions of Alberta and Ontario have allowed poison pills to stand in the face of an unsolicited take-over bid, making it impossible for the bidder to take up shares under its bid.

In *Re Pulse Data Inc.*, (2007) ABASC 895, Seitel, Inc. made an unsolicited all-cash take-over bid for all of the shares of Pulse Data at a price that represented a premium of 3.3 per cent to the closing price of the shares on the day prior to the bid. The Pulse Data board had concerns about the bid, including its very low premium and the risk that Seitel would waive its 66 2/3 per cent minimum tender condition and acquire a significant minority position in Pulse Data. Following commencement of the bid, Pulse Data adopted a rights plan, which required a bid to have the support of holders of at least 50 per cent of the shares held by independent shareholders (*i.e.*, those independent of the bidder) in order for the bid to be a "permitted bid" which would not trigger the plan. Pulse Data put the rights plan to its shareholders for a vote before the hearing on the rights plan was held, and approximately 98 per cent of the shares represented at the meeting (excluding the bidder's shares) were voted in favour of the rights plan. At the hearing, Pulse Data indicated that there was no ongoing auction for the company. The ASC refused to cease trade the rights plan, holding that it was reluctant to "interfere with a decision of the Pulse Board that has a fiduciary duty to act in the best interests of Pulse Shareholders, particularly when that decision had very recently been approved by informed Shareholders".

In *Re Neo Material Technologies Inc.*, (2009) 32 OSCB 6941, Neo Material had an existing conventional rights plan which had been previously approved by its shareholders. Pala Investments, the owner of approximately 20.5 per cent of Neo Material, made an unsolicited bid structured as a "permitted bid" which would not trigger the then-existing rights plan. The Pala bid was a partial bid for up to an additional 20 per cent of Neo Material (subsequently decreased to 9.5 per cent at a higher offer price). The Neo Material board was concerned that the bid would give Pala effective control over Neo Material without payment of an appropriate control premium for the shares purchased, and no premium for the shares not purchased. In the face of the bid, the board of Neo Material adopted a second rights plan that required that any take-over bid be made for all shares of Neo Material in order to be considered a "permitted bid" under the plan. Although the Neo Material board considered alternatives to maximize shareholder value, the board ultimately concluded that the time at which the Pala bid was made was an inappropriate time for the company to run an auction or allow effective control to be acquired by any one shareholder, thus impeding a potential future sale transaction.

Neo Material put the second rights plan to its shareholders for a vote before the hearing on the rights plan was held, and approximately 81 per cent of the shares represented at the meeting (excluding the bidder's shares) were voted in favour of the rights plan. At the hearing, the OSC refused to cease trade the rights plan.

The key common elements of the *Pulse Data* and *Neo Material* decisions were that: (i) the relevant rights plans were tactical – meaning that they were adopted in the context of, and in response to, an unsolicited bid; (ii) the rights plans received shareholder approval during the course of the unsolicited bid; (iii) the evidence supported a finding that shareholders were provided with sufficient information to allow them to reach an informed decision as to how to vote their shares when considering their support for the rights plan; and (iv) there was no evidence to suggest that management coerced or pressured the shareholders to approve the rights plans. While in the usual case a target adopts a rights plan to give it more time to assess and bring forward alternatives, in these cases the rights plans were adopted specifically to impede a bid that the target company board viewed as not being in the best interests of shareholders. In each case, the bidder terminated its acquisition efforts when it was unable to obtain the requested cease trade order.

The various securities commission rights plan decisions that precede *Pulse Data* and *Neo Material* were heavily focused on shareholder choice and enfranchising shareholders to make their own decisions about whether or not to accept a hostile offer to acquire their shares. We regard the *Pulse Data* and *Neo Material* decisions as important extensions of the shareholder choice principle. In each case, the independent shareholders present at a meeting to vote on a rights plan chose by an overwhelming majority to allow the rights plan to continue, recognizing that doing so could thwart the ongoing change of control transaction. The commissions were prepared to accept and support that shareholder choice, even though the effect of doing so was that shareholders who did not vote in favour of those rights plans would be deprived of the right to sell their shares to the hostile bidder.

Also significant in these decisions is that in each case, the regulator considered the fiduciary duties of the board in adopting the rights plan — a matter that generally has been within the purview of the Canadian courts rather than the provincial securities commissions, given the application of corporate law fiduciary duty requirements and judicial precedent to a fiduciary duty compliance analysis. This prompted some speculation that, in compelling circumstances, the ASC and the OSC may be willing to defer to the business judgment of the board where the board has acted in accordance with its fiduciary duties and has followed a defensible process. To this effect, the OSC in *Neo Material* acknowledged that while the primary purpose for adopting a shareholder rights plan historically has been to allow the board to pursue alternative value enhancing transactions, "shareholder rights plans *may* be adopted for the broader purpose of protecting long-term interests of the shareholders, where, in the directors' reasonable business judgment, the implementation of a rights plans would be in the best interests of the corporation". The ASC in *Pulse Data* appeared to

reach a similar conclusion when it voiced a reluctance to interfere with a decision of the Pulse Data board acting in accordance with its fiduciary duties.

The *Neo Material* and *Pulse Data* decisions demonstrate a willingness of the ASC and the OSC to allow a board to rely on a rights plan to defeat, rather than delay, an unsolicited bid on the basis of informed shareholder approval and represent an acknowledgment that there are circumstances in which a rights plan may properly have another purpose than simply allowing a board to pursue an alternative transaction in the face of a hostile bid. The majority decision of the British Columbia Securities Commission ("BCSC") in *Icahn Partners LP v. Lions Gate Entertainment Corp.*, (2010) BCSECCOM 432, on the other hand, reached a conclusion that cannot easily be reconciled with *Pulse Data* and *Neo Material*, and once again raised to the forefront the question of whether a target board in Canada can properly "just say no" to an unwanted hostile bid and a sale of control, even if the board has substantial shareholder support for such a decision.

In *Lions Gate*, Icahn Partners launched an unsolicited partial take-over bid in an effort to increase its shareholding from 19 per cent to approximately 29.9 per cent of the outstanding shares. In response, the Lions Gate board recommended that shareholders reject the bid and adopted a tactical rights plan. The next day, following the tactical road map laid out in *Pulse Data* and *Neo Material*, the board sent a notice to shareholders calling a meeting to consider and ratify the rights plan.

Following the board's adoption of the rights plan, Icahn amended its bid by increasing the offer price and offering to acquire all of the outstanding shares of Lions Gate. Under the terms of its amended offer, Icahn reserved the right to waive the minimum tender condition. The expiry date for the amended bid was four days prior to the meeting to vote on the rights plan. One week prior to the meeting to consider the rights plan, the BCSC held a hearing and ruled that the rights plan should be cease traded.

Relying on National Policy 62-202 – *Take-Over Bids – Defensive Tactics* and on the rights plan decisions prior to *Pulse Data* and *Neo Material*, the majority decision of the BCSC identified the primary objective of the take-over bid provisions in Canadian securities legislation as "the protection of the *bona fide* interests of the shareholders of the target company". It went on to state that central to this objective is the protection of the fundamental right of each shareholder to decide whether or not to accept a hostile bid. Accordingly, the majority rejected the idea that a rights plan could ever be left in place if the effect of doing so would be to defeat a bid.

Unlike the rulings in *Pulse Data* and *Neo Material*, the majority of the BCSC panel ruled that a shareholder rights plan can only be used as a temporary defence and that "in the absence of any attempts by the target company board to take any steps to increase shareholder value through an improvement of the bid or the presentation of alternative transactions, there is no basis for allowing [a rights plan] to continue". In other words, the majority view was that in the absence of a real and substantial possibility of the target board producing a better transaction for shareholders to consider, there would be no basis to allow a rights plan to survive.

In reaching its conclusion, the BCSC expressly rejected the position that *Pulse Data* and *Neo Material* stood for the proposition that a target company can "just say no" to a bid where the target's shareholders approve a tactical rights plan in the face of the bid, holding that such a principle simply cannot co-exist with the principle that shareholders must always have the opportunity to decide whether to tender to a bid. It also rejected the reliance that the panels in *Pulse Data* and *Neo Material* placed on the informed shareholder approval of the rights plans, holding that shareholder approval is not relevant where there are no alternatives to the bid and the board has no intention of seeking any.[2] The BCSC decision, taken to its logical conclusion, stands for the proposition that even if holders of all but a single share of a target company vote in favour of the continuation of a rights plan (or any other defensive barrier that may be devised in the future) in order to thwart a proposed change of control transaction that both the board and those shareholders consider to be contrary to their economic interests, the failure to obtain the support of the holder of the last remaining share will be fatal to the continuation of that rights plan, notwithstanding that the dissident holder is free to sell its single share through the markets at a price that most likely would closely approximate the price offered by the hostile bidder. The wisdom of that regulatory approach is open to question.

The relevance of directors' fiduciary duties and the business judgment rule were revisited by the OSC in the most recent Canadian rights plan decision, *Re Baffinland Iron Mines Corp.*, (2010) 33 OSCB 11385. In that case, Nunavut Iron Ore Acquisition Inc. was seeking to cease trade the rights plan that had been adopted by Baffinland Iron Mines Corporation (and approved by its shareholders) over a year before Nunavut's unsolicited bid. Unlike *Neo Material* and *Pulse Data*, this was not a situation where a tactical pill received shareholder approval in the face of an unsolicited bid. Importantly, at the time of the OSC hearing, Baffinland's sale process had culminated in a support agreement with a white knight, ArcelorMittal S.A., in which Baffinland agreed to recommend ArcelorMittal's bid and not to solicit other offers.

Baffinland argued, among other things, that the OSC should assess the factors relevant to its decision whether or not to cease trade the rights plan "through the lens of deference to the reasonable business judgment of the target company's directors" contemplated in *Neo Material*, and thereby defer to the Baffinland board's decision that the rights plan should stay in place until the expiry of the favoured ArcelorMittal bid.

The OSC clearly disagreed with this characterization of its prior decision, indicating that *Neo Material* does not stand for the proposition that the OSC will defer to the business judgment of the

target board in determining whether to cease trade a rights plan. Rather, the OSC viewed *Neo Material* as a situation in which it was prepared to defer to the wishes of shareholders who voted overwhelmingly to keep the rights plan in place in the face of the specific bid that was before shareholders at the time of the vote. The OSC stressed that the board's compliance with its fiduciary duties was a secondary consideration, not determinative of the outcome of a rights plan hearing.

In light of the key facts that drove the OSC's decision in *Neo Material*, and Baffinland's failure to seek or obtain shareholder approval of its rights plan after announcement of Nunavut's bid, it should come as no surprise that the OSC cease traded the Baffinland rights plan. Any other determination would have represented a significant deviation from the principles that for many years have formed the foundation of the OSC's approach to the regulation of rights plans.

IRRECONCILABLE DIFFERENCES — WHAT NOW?

There are currently two divergent and apparently irreconcilable views on the ability of a board to "just say no" to a hostile bid that the board considers contrary to the economic interests of shareholders. On one hand, the securities commissions in Alberta and Ontario consider informed shareholder consent of a rights plan by target shareholders in the face of a hostile bid to be of significant relevance in deciding whether to cease trade a rights plan, and may well uphold a rights plan on this basis even where there are no alternatives to the bid being sought. In contrast, the majority of the BCSC panel in *Lions Gate* has said such shareholder approval is irrelevant to the decision.

For many years, the Canadian securities regulators have operated on an understanding that the securities commission in the province in which the head office of the target company is located will have primary regulatory responsibility for any bid made for that company. The dramatically different approaches taken by the ASC in *Pulse Data* and the OSC in *Neo Material* as compared to the approach taken by the BCSC in *Lions Gate* raises an obvious concern that remains unresolved even following the decision in *Baffinland*.

In most instances, target shareholders can be expected to welcome the opportunity to tender their shares to a bid made at a substantial premium to the prevailing trading price. In those circumstances, there is little prospect that shareholders would be prepared to support the continuation of a rights plan that would thwart the bid, so the divergent positions of the Canadian regulators will be irrelevant.

It is, however, easy to imagine circumstances in which a bid is announced at a very low or non-existent premium or a partial bid is announced at a substantial premium but for a small fraction of the outstanding shares, where shareholder support for the bid may be weak. In those circumstances, there is now a very real prospect that the success or failure of the target board in defending against the bid will be heavily dependent on the location in Canada of the target company's head office. There are few, if any, market participants who regard this as a positive development in the Canadian regulation of hostile change of control transactions. ■

1. In this article, unless otherwise indicated, references to the United States mean, more specifically, the State of Delaware – the home to more than 50 per cent of all publicly-traded companies in the US – including 63 per cent of the Fortune 500.
2. In her minority decision, Commissioner Williams agreed with the decision reached by the majority to cease trade the pill, but differed on approach. She expressed the view that *Pulse Data* and *Neo Material* represent a natural evolution of policy interpretation and agreed that facts may exist that require further consideration before determining whether it is in the public interest to cease trade a rights plan. While acknowledging that there may be circumstances where it is appropriate to allow a rights plan to survive to fend off a bid, Commissioner Williams concluded that the level of shareholder support for the Lions Gate rights plan (based on initial proxy results available on the date of the hearing) was insufficient to warrant restricting shareholder rights.