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The New Take-Over Bid Playing Field: A Farewell to Shareholder Rights Plans and an Endorsement of Hard Lock-Up Agreements

Kate Byers, Lara Jackson, Jeffrey P. Roy

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The Ontario Securities Commission and the Financial and Consumer Affairs Authority of Saskatchewan recently released reasons for decision in connection with their December 2017 orders in the matter of the Aurora Cannabis Inc. unsolicited bid for CanniMed Therapeutics Inc. In this first decision to consider shareholder rights plans under the new take-over bid regime, the Commissions provide important guidance on the role of poison pills, the acceptability of "hard" lock-up agreements, the joint actor test, and the availability of exemptive relief from the 105 day bid period.

Key Takeaways

- **New take-over bid regime is here to stay.** There is little possibility that exemptions will be granted to bidders to shorten the 105 day bid period window.
- **Tactical shareholder rights plans may be obsolete under new regime.** The Commissions cease traded a tactical shareholder rights plan that interfered with the established features of the new take-over bid regime.
- **Lock-up agreements are green-lighted.** The Commissions recognized the use of "hard" lock-up agreements as an acceptable tactical tool for bidders and found that "measured" lock-up agreements did not create a joint actor situation.
- **Joint actor status not triggered by transmission of confidential information.** Aurora and shareholders who provided Aurora with material non-public information were not joint actors since they were fundamentally on different sides of the transaction.

Key Facts

In November 2017, CanniMed, one of the first licensed marijuana producers in Canada, was in advanced discussions with Newstrike Resources Inc., another licensed producer of medical cannabis, via a friendly acquisition of Newstrike by CanniMed pursuant to a plan of arrangement transaction.[1] The CanniMed board was not unanimous in its support for the Newstrike transaction, with two directors strongly objecting and advocating for a possible sale of the company. Information regarding the Newstrike transaction was shared with a third shareholder, who advised Aurora, a competitor of CanniMed, of the timing and nature of the CanniMed board deliberations. Aurora immediately began an assessment of a possible bid for CanniMed

and entered into “hard” lock-up agreements with four shareholders collectively holding 36% of CanniMed’s shares, including the two shareholders with CanniMed board representation, under which the shareholders agreed to tender their shares to an Aurora bid and vote against the Newstrike arrangement, and could not tender to a superior bid.

Aurora made an offer to acquire CanniMed immediately prior to the CanniMed board meeting to approve the Newstrike transaction. The CanniMed board considered the Aurora bid but ultimately decided to proceed with the Newstrike arrangement. Aurora then announced the launch of an unsolicited take-over bid to acquire CanniMed, conditional on the termination of the Newstrike transaction. In response to the bid, CanniMed’s board adopted a shareholder rights plan that prevented Aurora from acquiring additional CanniMed shares or from entering into any additional lock-up agreements.

Aurora filed an application for exemptive relief to shorten the minimum deposit period for its bid from 105 days to 35 days and for an order cease-trading the CanniMed rights plan. The Special Committee of CanniMed applied for orders that Aurora’s offer be considered an “insider bid”, which would trigger formal valuation and other requirements, and that Aurora and the locked-up shareholders be considered “joint actors” such that their shares would be excluded from the 50% minimum tender condition. CanniMed filed its own application seeking to prevent Aurora from purchasing any CanniMed shares prior to the expiry of the Aurora offer.

The Commissions convened a joint hearing on an urgent basis and on December 22, 2017, made orders (i) cease-trading the CanniMed rights plan, (ii) denying the exemptive relief for the Aurora bid, (iii) denying CanniMed’s request that Aurora be prohibited from acquiring up to 5% of CanniMed’s common shares during the takeover period, (iv) finding there was insufficient evidence to establish that Aurora and the locked-up shareholders acted jointly or in concert, and (v) ordering additional disclosure by Aurora. A month later, Aurora and CanniMed reached agreement on a friendly $1.1B acquisition of CanniMed by Aurora.

Notwithstanding this ultimate resolution of the hostile bid, the highly-anticipated reasons for decision behind the Commissions’ orders provide useful insight into the regulators’ approach to shareholder rights plans and requests for exemptive relief under the new take-over bid regime.

No Exemption: 105 Day Bid Periods are the Rules of the Game

The amendments to the take-over bid regime that came into force in May 2016 impose a 105-day minimum initial deposit for take-over bids and a 50% minimum tender condition (NI 62-104, section 2.28.1). The alternative transaction exemption under NI 62-104 permits a bidder to reduce the deposit period if the target company announces that it intends to effect an alternative transaction under which the target shareholder’s interest in the issuer is extinguished.

Aurora argued that the policy rationale for the exception provided in NI 62-104 was present, since the

Newstrike transaction was akin to an “alternative transaction” and the exemption would allow CanniMed shareholders to consider both the Newstrike and Aurora transactions during the same time period, as competing offers. Otherwise, the Newstrike transaction would be voted on before the expiry of the 105-day deposit period. The Commission did not agree that the Newstrike was an ‘alternative transaction’ in the spirit of the exception. CanniMed shareholders would continue as shareholder of CanniMed following an acquisition of Newstrike and the fact that Aurora included a condition that the Newstrike transaction not be completed did not make the Newstrike transaction an “alternative transaction”.

In denying the application, the Commissions stressed the importance of predictability in the new take-over bid regime. We expect the Commissions will continue to support the new playing field in takeover bids absent very unusual circumstances.

The Future of Tactical Shareholder Rights Plans

This proceeding marks the first consideration by regulators of rights plans under the new regime. When the new take-over bid regime was introduced, there were no changes to the defensive tactics policy statement. However, traditional rights plans became obsolete as a result of the 105-day bid period, which provides issuers with the additional time that was previously provided through rights plans. As a result, the Commissions found that previous decisions on shareholder rights plans were of limited use in their analysis.

The CanniMed rights plan deemed all securities subject to lock-up agreements to be beneficially owned by Aurora, resulting in a denial of the 5% exemption under subsection 2.2(3) of NI 62-104, and prevented Aurora from entering into any additional lock-up agreements or acquiring any CanniMed shares. It was implemented (without shareholder approval) on the day before Aurora could begin to make any purchases under the 5% exemption. The Commissions determined that the rights plan was clearly a defensive tactic as its function was not primarily to give the CanniMed board time to conduct an auction or to allow time for higher bids to emerge – rather, its primary function was to protect the Newstrike proposal and prevent additional lock-ups and permitted market acquisitions that could lead to Aurora’s success. The Commissions found that shareholder choice was already promoted outside of the rights plan since shareholders would be able to decide on the Newstrike transaction well before the expiry of 105-day bid period for the Aurora offer. The Commissions noted that lock-up agreements are even more important in the face of the take-over bid amendments, and shareholder rights plans that operate to prevent such lock-ups could make the take-over regime “far less predictable”. The Commissions concluded that it will be a “rare case” in which a tactical plan will be permitted to interfere with the established features of the take-over bid regime.

Importantly, the decision leaves open the question of whether regulators will intervene to cease trade a rights plan that was put in place and approved by shareholders in advance of a bid. Issuers that do not currently have a rights plan in place will no doubt consider whether to seek shareholder approval of one before it becomes too late.

Hard Lock-Up Agreements Advance the Rules of the Game

CanniMed sought to have Aurora and the locked-up shareholders designated as "joint actors" based on the hard lock-up agreements. This would cause the shares held by the joint actors to be excluded from the 50% minimum tender condition, and the votes attaching to those shares to be excluded from any minority approval of a subsequent acquisition transaction. The Commissions considered the lock-up agreements pursuant subsection 1.9(3) of N1 62-104, which states that there is a rebuttable presumption that an agreement to exercise voting rights leads to joint actor status. The presumption was rebutted since the lock-up agreement voting provisions were tailored to be consistent with and to support otherwise permissible commitments to tender securities to a bid. The Commissions did recognize that such lock-up agreements can raise public interest concerns, but did not find the Aurora lock-up agreements objectionable. The Commission agreed with Staff's submissions that "lock-up agreements are a lawful and established feature of the planning for M&A transactions in Canada". We expect that lock-up agreements will take on even more significance in future M&A transactions given the Commissions' unqualified endorsement of their importance in the new take-over bid regime.

Joint Actor Designation Not a Remedy for Breach of Confidentiality

The Regulators also denied CanniMed's request that Aurora and the locked-up shareholders be deemed "joint actors" on the basis of the provision of material non-disclosed information to Aurora. While finding that the knowledge of the CanniMed board deliberations was "extremely valuable" to and allowed Aurora to pursue its bid on an accelerated basis, by the time the bid was made, the material non-public information had been "cleansed" through the public disclosure of the Newstrike arrangement. The Commissions recognized that the improper transfer of information may warrant joint actor remedies in some cases, for example where the transfer of information prevented an auction process or denied shareholders a choice, or if the locked-up shareholders received any unique benefits. However, the locked-up shareholders were fundamentally on different sides of the transaction from Aurora and did not receive any benefits that were different than the benefits all shareholders would receive under the Aurora bid. Instead, the Commissions ordered that Aurora's disclosure be amended to include information such as the circumstances under which, and the means by which, Aurora became aware that the board of CanniMed would be meeting to consider the Newstrike arrangement, and further details about any information "obtained directly or indirectly by Aurora from any person who is, or was at the relevant time, in a special relationship with CanniMed". Aurora complied with this order but reached the friendly deal with CanniMed less than two weeks later. In the circumstances of this case, the provision of material non-disclosed information arguably led to an uneven playing field with no significant regulatory consequences.

If you have any questions concerning this case or securities litigation generally, please contact Lara Jackson, Jeffrey Roy, Wendy Berman or any other member of the Cassels Securities Litigation Group.

[1] Cassels Brock represented Newstrike in connection with the plan of arrangement.