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Canadian Securities Administrators Issue Proposed Changes to the Takeover Regime

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On September 11, 2014, the Canadian Securities Administrators ("CSA"), the authorities responsible for the regulation of Canadian securities markets, issued CSA Notice 62-306 proposing significant changes to the takeover regime. The proposals represent a change in methodology from the approaches presented by the CSA in March, 2013, which addressed the permissible use of "poison pills" (shareholder rights plans) in response to hostile takeovers. In recent years the CSA had appeared divided on this issue, which has often been framed in terms of the question who should have the biggest say on responding to a hostile takeover, the target's directors or its shareholders?

In the context of hostile bids, the purpose of a poison pill is to put greater control in the hands of the target's board. Poison pills are often considered by boards to be necessary in light of the current takeover bid regulatory regime which is generally viewed as being favorable to bidders. Restrictions placed on their use by the CSA led to the predominant view that shareholders must have the right to respond to a hostile bid in a relatively short timeframe, and that the target's board should not be allowed to prevent that response, even if the board's objective is to secure a better price. In Canada, since1992 at least, the prevailing view has been that at some point "the pill has to go". As stated in the Notice, the time period was typically 45-55 days after a hostile bid commenced, on the basis that the only legitimate use of a poison pill in response to a bid was to buy time for the board to seek a better offer. If within that timeframe the Board had not come up with an alternative, then shareholders would have to be given the right to decide individually whether or not to tender to the bid.

An underlying premise of this approach was that it was not acceptable for the board to take the position that no sale at all was appropriate, or to use the pill to bargain with the bidder for a higher price, in the absence of an alternative offer. This approach meant that, once a hostile bid was commenced, the only question was likely to be who was to acquire it and for how much. The idea of a "free vote" by shareholders in which they might decide not to tender was often illusory, given the positions taken by arbitrageurs and the fear of being left in a minority, devalued and less liquid position if the bidder achieved its minimum tender condition.

Despite that prevailing regulatory position, in a number of instances securities commissions have allowed pills to remain outstanding for a longer period where the shareholders of the target had approved the pill, or reconfirmed it, in the face of the bid. Instead of asking whether the board or the shareholders should have the biggest say, these cases in effect contrasted the individual right of the shareholder to tender to the bid with the collective right of the shareholders to authorize the board to block the bid. A focus on collective action was manifested in the March 2014 proposal of the Quebec securities regulator which averted to the existing takeover regime being "structurally coercive to target securityholders as it does not permit them to make a collective decision about the transaction".

The 2013 CSA proposals focussed on how to regulate poison pills. The CSA has now abandoned the approach outlined in the 2013 proposals in favour of proposing changes to the takeover regime itself. The September 2014 Notice proposes that the minimum time for which a bid must remain outstanding be extended from 35 days to 120 days, and that any bid must be subject to a "mandatory tender condition" that a minimum of more than 50% of all outstanding target securities be tendered. The first of those provisions gives the board an extended timeframe to solicit other offers, and to attempt to have the bidder increase its bid. The second means that, if a majority of shares are tendered to the existing bid, there can be no argument that a majority of the shareholders want the board to have the ability to continue blocking the bid. A third change will require the bidder to extend the bid for 10 days after achieving the minimum tender condition and announcing that it will take up deposited securities. This change eliminates the concern that by not depositing shares (because it does not favour the bid) a shareholder may miss out on selling its shares and hence be left in a diminished position, which is seen as the "structural coercion" of the existing system.

Assuming they become law, these provisions may effectively put an end to the use of poison pills in response to hostile takeovers. If after 120 days and a tender of over 50%, the board continues to try to block the bid, we expect that there would need to be exceptional circumstances to persuade a regulator not to cease trade the pill. This would mean that putting a "tactical" pill in place following commencement of a bid is likely to be unnecessary and ineffective. Nonetheless, issuers will likely still adopt pills to prevent offerors from effecting "creeping takeovers" without making a formal bid, and such a pill will be more likely to obtain shareholder approval (which has been a TSX requirement) if it contains a "permitted bid" exception for formal bids that comply with the takeover bid rules, amended as contemplated.

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