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Update

Corporate Securities Law

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The HudBay Minerals Proceedings and the Return of Acquiror-Side Shareholder Approval Rights

The January 23, 2009 decision of the Ontario Securities Commission (the "OSC") in a proceeding initiated by significant shareholders of HudBay Minerals Inc. ("HudBay") seeking voting rights in connection with HudBay's proposed acquisition of Lundin Mining Corporation ("Lundin") raises questions about whether and when shareholders *of the acquiror* should have the right to vote on acquisition transactions.

The Background

This past November, HudBay announced a deal to purchase all the outstanding shares of Lundin. Under the proposed transaction, each Lundin share would be exchanged for 0.3913 HudBay shares, such that the current HudBay shareholders and the current Lundin shareholders would each, as a group, hold approximately 50% of the shares of HudBay post-closing. HudBay received the approval of the Toronto Stock Exchange (the "TSX") to list the HudBay shares proposed to be issued to Lundin shareholders, without being required to have a vote of the HudBay shareholders.

The Decision

On January 23, 2009, the OSC set aside the decision of the TSX. The OSC determined that, because of the impact that the transaction might have on HudBay shareholders, the "quality of the marketplace…would be significantly undermined" if the transaction were to proceed without HudBay shareholder approval.

The Issue

The core question is whether, in circumstances where a publicly-traded acquiror is seeking to acquire another issuer and to pay for the acquisition by issuing shares, the shareholders of the acquiror should have the right to vote to approve (or not approve) the transaction.

The issue has a unique Canadian dimension. Under the TSX rules, acquisitions of publicly traded targets are generally exempted from the general rule that acquirors obtain approval of their shareholders for acquisitions involving issuances of stock in excess of 25%, though the TSX retains discretion to impose a shareholder approval requirement taking into account the effect that the transaction may have on the "quality of the market." By contrast, the New York Stock Exchange uniformly requires shareholder approval for transactions which would cause a company to issue more than 20% of its stock, while the London Stock Exchange has a threshold of 25%, *whether or not the target is publicly traded*. The TSX exemption was introduced in 2005 on the basis that Canadian companies generally have less access to capital and credit than their international counterparts.

The OSC's Analysis

In considering the effect that the transaction may have on the quality of the marketplace, the OSC made note of the following factors:

- *Impact on HudBay's shareholders* – the OSC noted the "obvious impact" that the transaction would have on HudBay and its shareholders;
- *Dilution* – the OSC characterized the level of dilution that the HudBay shareholders would

experience as "extreme... at the very outer end of the range of dilutions in prior transactions before the TSX." The OSC questioned how, in a merger of equals, it could be fair for one party's shareholders (i.e. Lundin's) to be entitled to vote while the other party's are not;

- *Board of the acquiror* – the terms of the transaction contemplated a reconfigured board for HudBay, with the nine-member board of HudBay post-closing to include five directors from the Lundin board. The OSC noted that though "not every change in a board's composition requires shareholder approval" a change as fundamental as that contemplated by the proposed transaction does; and
- *Timing of shareholder votes* – the OSC observed that the timetable for the transaction had been accelerated (with what the OSC calls "uncommon haste") to occur prior to the time fixed for HudBay's requisitioned shareholders meeting. The OSC noted that the scheduling appeared to have been designed with the objective of "frustrating the legitimate exercise by HudBay shareholders of their right to require a shareholders meeting to consider the replacement of the HudBay board," characterizing the result as "fundamentally unfair to the shareholders of HudBay."

Other Proceedings

To highlight the contentiousness of the issue, another shareholder group, led by SRM Global Master Fund, HudBay's largest shareholder, had filed an oppression application in the Ontario Superior Court against HudBay in an attempt to block the transaction; given the OSC's decision, it is unlikely that that action will proceed. Also, Ontario Teachers' Pension Plan disclosed that it was writing to the TSX supporting the shareholders' objections and encouraging the TSX to change its rules surrounding the approval of dilutive transactions without shareholder consent.

What does this Mean?

In practical terms the OSC's decision is likely to have the following effects in the context of M&A transactions:

- *Structuring* - the ability to complete acquisitions without shareholder approval can be a significant advantage, in that it permits acquirors to propose transactions with reduced conditionality and enhanced ability to close quickly. Parties considering or negotiating share exchange transactions will now have to consider carefully whether shareholder approval may be required on the acquiror side even if the transaction structure wouldn't otherwise require shareholder approval under applicable corporate law and Rule 61-501 (and as to how proceeding without shareholder approval might affect transaction certainty given shareholder reactions to, and the variety of tools used to challenge, HudBay's proposed course).
- *TSX approvals* - it can be expected that the process of seeking TSX approval for share exchange transactions may change, as the TSX may seek supporting information concerning the effect of the proposed transaction on the "quality of the marketplace." Issuers may want to provide substantive support for any position taken that shareholder approval should not be required.
- *Reconsideration of the rules* – It is reasonable to expect that the TSX rules will be reconsidered in light of the OSC's decision. In fact, the OSC in its decision indicated that the TSX is currently considering whether there should be a specified maximum dilution above which shareholder approval would automatically be required.

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