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Update

Corporate Securities Law

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The Sunrise REIT/Ventas Decision

The Ontario Superior Court's decision of March 6 concerning the contested auction for Sunrise Senior Living Real Estate Investment Trust (Sunrise REIT) has raised many questions, and stirred much debate and speculation, about its impact on M&A in Canada.

By way of background:

- Sunrise REIT is a publicly traded owner of 74 seniors residences, all managed by Sunrise Senior Living Inc. (SSL). SSL is a U.S. public company and is one of the largest North American providers of property management services for senior care facilities.
- In November 2006, Sunrise REIT initiated a strategic sale process. The parties who participated in this process were required to sign a confidentiality agreement in favour of Sunrise REIT. Among other things, these confidentiality agreements generally prohibited potential purchasers from negotiating with SSL and making an offer to purchase Sunrise REIT without the prior approval of the board of trustees of Sunrise REIT for 18 months.
- Two parties - Ventas Inc. (Ventas) and Health Care Property Investors, Inc. (HCP) - were selected to move into a final round of negotiations with Sunrise REIT. Ventas submitted an offer of $15.00 per unit. HCP withdrew from the process because it was unable to negotiate acceptable terms with SSL for continued management of the Sunrise REIT assets by SSL.
- On January 14, Sunrise REIT and Ventas entered into a purchase agreement pursuant to which Ventas agreed to indirectly acquire substantially all of Sunrise REIT's assets for cash consideration equal to $15.00 per Sunrise REIT unit. Ventas also entered into an agreement with SSL to manage the assets to be purchased on successful completion of its offer.
- On February 14, 2007, HCP offered to acquire Sunrise REIT at a price of $18.00 per unit on terms that were "otherwise identical" to those set out in the purchase agreement between Sunrise REIT and Ventas. The terms of the offer suggested that it was also conditional on HCP reaching an agreement with SSL.

The courts became involved when Ventas initiated action seeking to compel Sunrise REIT to enforce the terms of HCP's standstill agreements (effectively to prevent Sunrise REIT from accepting HCP's proposal) and to prevent negotiations between HCP and SSL which would be necessary in order for HCP's offer to proceed.

The court's decision, rendered by Madam Justice Sarah Pepall, turns principally on the interpretation of specific terms of the Sunrise REIT/Ventas purchase agreement. The purchase agreement, as is typical, included "no shop" provisions restricting Sunrise REIT from soliciting alternative proposals, and "fiduciary out" provisions designed to permit the Sunrise REIT board to respond to and accept superior competing proposals in specified circumstances. Notably, however, Sunrise REIT's obligation under the purchase agreement to enforce standstill agreements in its favour was *not* qualified by reference to the "fiduciary out" sections of the agreement. On this basis, the court concluded that Sunrise REIT should be required to enforce HCP's standstill, notwithstanding the HCP's proposal appears to be superior to the Ventas transaction. However, the court also stated, as an additional basis for its decision, that HCP's proposal could not qualify as a superior proposal as defined in the purchase agreement in that it was made in breach of HCP's standstill agreement and could therefore not be considered to be "bona fide."

If the Sunrise REIT decision is considered to be simply a case of contractual interpretation, its effect may

be quite limited. Specifically, target boards and their advisors may simply look again at their preferred forms of purchase or support agreement (a) to ensure that the "fiduciary out" provisions qualify *all* of the covenants that might affect an issuer's ability to consider and facilitate a superior offer, (b) to clarify, where such is the case, that no distinction is to be made between superior bids from participants in an earlier process and bids from newcomers, and (c) more generally, to ensure that the spirit of the "fiduciary out" language is not frustrated by specific or mechanical language in the agreement. Moreover, participants in the M&A arena may look closely at whether standstill agreements should fall away in the face of a publicly announced deal (Ventas' standstill included such a "self-destruct" mechanism while HCP's, regrettably for it and for Sunrise REIT, did not).

The decision, however, raises additional interesting questions, both for the Sunrise REIT auction itself and more generally for M&A transactions, including:

- Whether the decision implies that target boards of directors can contract out of their fiduciary duties. It is widely thought, based largely on analogous American jurisprudence, that boards cannot contractually constrain their ability to discharge their fiduciary duties, but the Sunrise REIT decision upholds a contractual provision that may frustrate the board's ability to facilitate an apparently superior offer. (The court noted that the Sunrise REIT unitholders can reject the Ventas offer, at which time the purchase agreement could be terminated, allowing Sunrise REIT to waive the HCP standstill. However, there is no certainty for unitholders that HCP will be able to reach a deal with SSL and will still "be there" at $18.)
- Whether a party in Ventas' position may, if its offer fails as an apparent consequence of the actions of a competing bidder, have a claim against such competing bidder, for example for tortious interference with economic relations. The answer to this question could raise interesting questions for parties engaged in strategic auction processes.

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