

# Goodmans<sup>LLP</sup> Update

## Securities Regulators Clarify Ground Rules for Take-Over Bids in Canada

On March 16, 2018, the Ontario Securities Commission (OSC) and the Financial and Consumer Affairs Authority of Saskatchewan (FCAAS) issued the reasons for their decision in *Re Aurora Cannabis Inc.* to, among other things, cease trade a shareholder rights plan adopted by CanniMed Therapeutics Inc. (TSX: CMED) in response to a hostile take-over bid for CanniMed made by Aurora Cannabis Inc. (TSX: ACB). This is the first time that a rights plan has been challenged since Canada's take-over bid regime was revamped in 2016. The reasons provide some initial guidance by two of Canada's securities regulators as to the approach they may take in the context of hostile take-over bids under the new regime, including with respect to the role of shareholder rights plans and lock-up agreements.

### Background

CanniMed and Aurora are both producers and distributors of medical marijuana with aspirations to participate in the anticipated recreational market for cannabis in Canada. In furtherance of that strategy, in mid-2017, CanniMed began discussing a possible strategic transaction between CanniMed and Newstrike Resources Ltd. (TSXV: HIP), a junior cannabis producer backed by The Tragically Hip. By the fall, the discussions had evolved into a potential merger of the two companies.

As the negotiations between CanniMed and Newstrike progressed, certain CanniMed board members who were nominees of some of CanniMed's largest shareholders opposed the proposed merger and tried to persuade the other member of CanniMed's board to pursue a sale of CanniMed instead. Some of those CanniMed shareholders then began directly contacting potential buyers in an attempt to persuade them to make a bid for CanniMed. The initiatives of those shareholders – which ultimately included entering into irrevocable or “hard” lock-up agreements to tender approximately 38% of CanniMed's outstanding shares – persuaded Aurora to make a bid for CanniMed under which CanniMed's shareholders would receive Aurora shares initially valued at an approximate 20% premium to CanniMed's trading price at the time.

After evaluating Aurora's initial offer, CanniMed's board determined to recommend against the offer and to approve the acquisition of Newstrike in exchange for approximately 35% of CanniMed's outstanding shares post-closing. Among other conditions, the Newstrike transaction required approval by CanniMed's shareholders.

Following CanniMed's public announcement of the Newstrike acquisition, Aurora formally launched its bid for CanniMed. The bid was conditional upon, among other things, the Newstrike transaction not proceeding. Under the new take-over bid rules, Aurora's bid was required to remain outstanding for at least 105 days (until March 9, 2018) before shares of CanniMed could be taken up (if all conditions were satisfied or waived), while CanniMed's shareholder meeting to approve the Newstrike transaction was scheduled to be held on January 23, 2018. In an attempt to mitigate CanniMed's timing advantage, Aurora applied to the OSC and FCAAS for exemptive relief to abridge its bid period to 35 days so that its bid could expire before the CanniMed shareholders meeting.

A few days after Aurora launched its bid, CanniMed's board adopted a shareholder rights plan that (i) had the effect of preventing Aurora (and the locked-up shareholders) from buying any additional CanniMed shares or entering into any other lock-up agreements, and (ii) imposed a number of terms on Aurora's bid that were more onerous than the statutory take-over bid rules. Shortly thereafter, Aurora applied to the OSC and FCAAS to cease-trade the rights plan. In response, a special committee of CanniMed's board (established to evaluate Aurora's bid) applied to the OSC and FCAAS for an order that Aurora and the locked-up shareholders were joint actors under Canadian securities laws, which would have a number of important implications for Aurora's bid that are discussed further below. Concurrently, CanniMed applied for an order preventing Aurora from purchasing any additional CanniMed shares while its bid was outstanding in the event CanniMed's rights plan was cease-traded.

## The Rights Plan

The OSC and FCAAS cease-traded CanniMed's shareholder rights plan. In doing so, they suggested that they are inclined, at least in the context of these facts, not to have rights plans alter the new statutory framework for formal take-over bids or interfere with certain lock-up agreements. Whether, and how, this may change the use of shareholder rights plans going forward – recognizing that most existing shareholder rights plans effectively prohibit hard lock-up agreements – remains to be seen.

## Joint Actor Status

CanniMed's special committee sought an order that Aurora and the locked-up shareholders were joint actors under Canadian securities laws on the basis of (i) the terms of the lock-up agreements, and (ii) the locked-up shareholders' role in developing Aurora's offer. If granted, this order would have significantly impacted Aurora's bid, including requiring a formal valuation to be prepared under the supervision of CanniMed's special committee (as it does not appear that any exemption from the formal valuation requirement would have been available) and that a majority of CanniMed's shares *excluding the locked-up shares* be tendered to Aurora's bid for the bid to proceed.

With respect to the lock-up agreements themselves, Canadian securities laws provide that an agreement to *tender* to a take-over bid does not, by itself, render the parties to the agreement joint actors in respect of the bid. However, a person who enters into an agreement to *vote* jointly or in concert with a bidder is presumed under Canadian securities law to be acting jointly or in concert with the bidder. In this case, the OSC and FCAAS concluded that the lock-up agreements did not render the locked-up shareholders joint actors with Aurora, even though they were "hard" lock-up agreements and required the shareholders to vote in a manner that furthered the objectives of Aurora (i.e., by voting against the Newstrike acquisition and other transactions that could interfere with Aurora's bid).

With respect to the locked-up shareholders' role in developing Aurora's bid, the OSC and FCAAS concluded that, fundamentally, the locked-up shareholders (as sellers) and Aurora (as the only buyer) were on opposite sides of the transaction. While the regulators concluded that CanniMed's confidential information had been used by the locked-up shareholders to facilitate Aurora's bid, they did so in furtherance of their own financial interests, not Aurora's. However, the regulators ordered that Aurora make certain supplemental disclosure (by news release and in an amended take-over bid circular) about the information that Aurora received leading up to its bid. In doing so, the regulators expressed the view that, at least when a bidder is offering its own shares under a take-over bid, non-financial facts that could impact target shareholders' confidence in the bidder's board or management (in this case, receipt of information that may have given Aurora a tactical advantage in launching its bid) may be material facts that are required to be disclosed in the bidder's take-over bid circular.

## Minimum Bid Period

Under the new take-over bid rules, if the target's board announces that it intends to effect certain transactions that would result in a change of control of the target, then the minimum bid period is automatically reduced from 105 days to 35 days. The Newstrike acquisition did not trigger this exception because the transaction would not have resulted in a change of control of CanniMed. Nonetheless, Aurora submitted that the policy rationale underlying the exception applied equally in this case since the Newstrike acquisition was in effect the same type of alternative to the Aurora bid as a competing change of control transaction, and CanniMed was not pursuing other alternatives to the Aurora bid.

The OSC and FCAAS rejected Aurora's arguments. The regulators focused on the fact that, unlike a change of control transaction, the Newstrike acquisition – even if completed – did not prevent Aurora from proceeding with its bid (i.e., it was Aurora itself who made its bid conditional upon the Newstrike acquisition not proceeding). The regulators also concluded that, as the Newstrike acquisition had been under consideration long before Aurora's offer materialized, it was not a defensive tactic. In their reasons, the regulators left open the possibility that the relief sought by Aurora could be provided in other circumstances, while implying that those circumstances would be relatively infrequent.

## Acquisitions of Target Shares During a Bid

There is a general prohibition on a bidder purchasing the target's shares once the bidder announces its intention to make a formal take-over bid. The only exception to that rule allows a bidder to buy up to 5% of the target's shares through normal course market purchases that are not pre-arranged, beginning three days after the bid has formally been launched (and provided the intention to do so has been publicly announced and purchases made in reliance on the exception are reported daily). CanniMed submitted that allowing Aurora to rely on this exception would unfairly prevent CanniMed's other shareholders from considering alternatives to the Aurora bid by giving Aurora an effective "blocking position".

The OSC and FCAAS rejected CanniMed's arguments. In the circumstances of this case, the regulators perceived no unfairness in permitting Aurora to rely on the statutory exception, particularly given that any shares acquired by Aurora in reliance on the exception could not be voted against the Newstrike acquisition since (i) the record date for voting had already passed, and (ii) the inability to pre-arrange trades prevented Aurora from obtaining a proxy to vote any shares acquired. Once again, the regulators left open the possibility that this relief could be granted in circumstances where the policy underlying the 5% exception would be undermined by allowing its use.

## Conclusion

The CanniMed decision provides targets and bidders with some initial guidance about the way Canadian securities regulators may approach shareholder rights plans and lock-up agreements under the new take-over bid regime. The decision seems to suggest a general predisposition on the part of the OSC and FCAAS not to allow the new regime to be tampered with through the use of defensive tactics (such as shareholders rights plans) or the granting of discretionary relief (absent evidence that the policies underlying the bid regime are being undermined).

The Aurora/CanniMed saga also reinforces the challenges that unwelcome bidders face under the new take-over bid regime. Thus far, experience has shown that most "successful" hostile bids are achieved through an eventual negotiated transaction between the bidder and the target. So it was in this case, with Aurora and CanniMed ultimately entering into a support agreement – on the eve of the CanniMed shareholders meeting to approve the Newstrike acquisition – pursuant to which CanniMed agreed to support an amended bid by Aurora at a 79% premium to its initial bid.

Please contact any member of our Corporate Securities Group to discuss these developments or their impact on any potential transaction.

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