Goodmans LLP Update

Corporate Securities Law

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OSC Intervenes in Private Placement Implemented During Proxy Contest

On April 23, 2017, the Ontario Securities Commission (OSC) overturned a decision of the Toronto Stock Exchange (TSX) conditionally approving a private placement by Eco Oro Minerals Corp. ("**Eco Oro**") in the midst of a proxy contest to replace the Eco Oro board. The OSC's order is the latest in a series of recent decisions by Canadian securities regulators considering the validity of so-called "tactical" private placements implemented in hostile situations such as unsolicited take-over bids, voting transactions and proxy contests.

Background

Eco Oro is a TSX-listed company whose main asset is an arbitration claim against the Government of Columbia to recover damages for the loss of the Angostura gold/silver mining project. In 2015, Eco Oro was in desperate need of capital to fund the arbitration proceeding and its working capital needs. After unsuccessfully attempting to raise funds through conventional financings, Eco Oro entered into a series of investment agreements principally with three institutional investors (two of whom were significant shareholders of Eco Oro) that secured the financing needed to continue operating and fund the arbitration. The investment agreements provided for the issuance of common shares and convertible notes to the investors in two tranches, with the shares issuable in the second tranche conditional upon TSX and shareholder approval, failing which the second tranche would consist of convertible notes and contingent value rights ("**CVRs**") that entitled the investors to a substantial portion of the proceeds of the arbitration proceedings if Eco Oro was successful. At a shareholders' meeting held in November of 2016, over 93% of disinterested shareholders voted against the issuance of shares for the second tranche. Accordingly, Eco Oro subsequently issued the convertible notes and CVRs to the investors in accordance with the terms of the investment agreements. Taken together, the convertible notes had an aggregate principal amount of approximately $9.7 million and the CVRs entitled the investors to over 70% of any proceeds from the arbitration. Notably, the terms of the convertible notes permitted Eco Oro to exchange the notes for equity at Eco Oro's discretion.

On February 10, 2017, certain dissident shareholders of Eco Oro requisitioned a shareholders' meeting to replace the board. Shortly thereafter, the investors publicly confirmed their support for the incumbent Eco Oro directors. At the same time, Eco Oro applied to the TSX to exchange a portion of the convertible notes into an aggregate of 10,600,000 common shares (representing approximately 9.98% of the outstanding common shares post-issuance such that no shareholder vote would be technically required under the TSX rules).

On March 2, 2017, Eco Oro announced that the requisitioned meeting would be held on April 25, 2017, and that the record date for determining which shareholders were entitled to vote at the meeting would be March 24, 2017. On March 10, 2017, the TSX conditionally approved the note exchange and Eco Oro announced the closing of the note exchange on March 16, 2017. Eco Oro stated that the purpose of the note exchange was to "de-risk" its balance sheet and enhance its financial flexibility. As a result of the note exchange, the investors' voting interest in Eco Oro increased from approximately 41% to 46%.

On March 22, 2017, the dissident shareholders filed a petition with the B.C. Supreme Court seeking to set aside the note exchange as oppressive. Shortly thereafter, on March 27, 2017, the dissidents applied to

the OSC for an order to set aside the TSX's decision to approve the note exchange without requiring the prior approval of Eco Oro's shareholders and to cease trade the common shares issued in exchange for the convertible notes.

B.C. Supreme Court Decision

The B.C. Supreme Court upheld the board's decision to implement the note exchange, despite its timing, on the basis that there was no evidence to suggest that the note exchange was not in Eco Oro's best interests and that the directors' decision was entitled to deference under the business judgment rule. The Court also held that the evidence supported a conclusion that the dissident shareholders had a reasonable expectation that the Eco Oro board may exchange all or a portion of the convertible notes for shares, and that the board would seek to time the exchange to coincide with an increased share price to obtain the most favourable share-for-debt exchange.

OSC Decision

The OSC set aside the TSX's decision to approve the note exchange. To give effect to that decision (given that the note exchange had already been completed), the OSC also ordered that

- a meeting of Eco Oro's shareholders be held to either ratify the note exchange or instruct the Eco Oro board to take all necessary steps to reverse the note exchange,
- the new shares issued pursuant to the note exchange be cease-traded unless and until Eco Oro's shareholders ratify the note exchange, and
- Eco Oro (and the Chair of any Eco Oro shareholder meeting) disregard the new shares for the purposes of voting at any meeting of Eco Oro's shareholders, including the requisitioned meeting to be held on April 25, 2017.

The full impact of the OSC's decision in Eco Oro will only be clear once the OSC's detailed reasons are released. However, the decision has captured the attention of market participants for a number of reasons:

- There has been considerable debate about the remedies available to securities regulators when intervening in private placements, particularly when the transaction has already closed. It will be useful to understand the basis for the OSC's jurisdiction for its decision to effectively "unwind" a completed private placement and deny the investors their right to vote outstanding shares, and the circumstances in which the OSC will exercise such a powerful remedy.
- There has been some uncertainty about the circumstances in which regulators will intervene in private placements in various contexts. While the basis for securities regulators' intervention in private placements in the take-over bid context is grounded in National Policy 62-202 – *Take-Over Bids – Defensive Tactics*, there is no equivalent policy that applies to proxy contests or voting transactions. According to the order, the OSC's decision to intervene in the Eco Oro private placement was based on its authority to review decisions made by the TSX (and not under its general authority to make orders in the "public interest"). It will be instructive if the OSC clarifies its view that it can also use its general public interest jurisdiction to intervene in a private placement implemented as a "proxy defence" in circumstances where the OSC does not believe there is a basis to set aside a TSX decision approving the private placement.
- The OSC's order follows the recent decision of the OSC and British Columbia Securities Commission (BCSC) *In the Matter of Hecla Mining Company and Dolly Varden Silver Corporation*, in which the OSC and BCSC established a new framework for evaluating private placements implemented in the context of unsolicited take-over bids (see our previous update, *OSC and BCSC Establish New Framework for Regulating Tactical Private Placements*). That framework places greater weight (relative to the established framework for evaluating shareholders rights plans or "poison pills") on the business judgment of the target's board and the possible benefits of the transaction

to the target and its shareholders. The reasons may be an opportunity for the OSC to establish a similar framework for evaluating tactical private placements implemented during proxy contests (and help market participants better understand if this analysis differs from its perspective on take-over bids).

- This decision is likely to impact the process for obtaining TSX approval of a private placement implemented during the course of a proxy contest. The OSC's reasons may provide some guidance as to how the TSX will approach its own approval process going forward.

Following the OSC's order, the B.C. Supreme Court has ordered the requisitioned meeting to be adjourned to a date set by the Eco Oro board (no later than September 30, 2017), to allow the parties time to resolve any conflicts between the decisions. It will be interesting to see whether the decisions of the B.C. Supreme Court and/or the OSC are appealed, and what other steps each side takes in the intervening period.

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