Goodmans LLP Update

Corporate Securities Law

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OSC Spider Decision Muddies the Waters for Rights Plans

On July 2, 2010, the Ontario Securities Commission released a decision concerning a challenge to the shareholder rights plan (or "poison pill") of Spider Resources Inc. Full reasons have not yet been released, and when they are they may shed light on the implications of the decision. For now, parties involved in or considering engagement in public M&A transactions are left with uncertainty, as the Spider decision is difficult to reconcile with earlier "poison pill" cases.

Generally speaking, Canadian securities regulators' decisions in "poison pill" cases have reflected the view that shareholder rights plans may be used to ensure that:

- all shareholders are treated fairly in connection with any take-over bid, and
- directors of a target board are provided with sufficient time to evaluate unsolicited take-over bids and explore and develop alternatives to maximize shareholder value.

In simple terms, with notable exceptions, Canadian securities regulators have generally permitted shareholder rights plans to stand only for so long as the issuer is developing, and/or there is a reasonable prospect that it may develop, an alternative for shareholders. The Spider decision may reflect a view of the OSC that shareholder rights plans will be permitted to stand for other purposes.

Background

The Rights Plan. Spider's rights plan had been adopted by Spider in May 2009 and approved by Spider's shareholders in June 2009.

The Initial Cliffs Proposal and Bid. In May 2010 Cliffs Resources launched a bid, unsupported by the Spider board, to acquire all of the outstanding common shares of Spider for $0.13 cash per share. Cliffs' offer was open until 5:00 pm (Eastern Time) on July 6, 2010 and contained a number of conditions, including a condition that the Spider rights plan be waived or invalidated.

The KWG Deal. In response to Cliffs' initial proposal, Spider entered into a combination agreement with KWG Resources Inc. That agreement gave certain customary deal protection rights to KWG, including a commitment by Spider not to solicit alternative transactions and a right for KWG to match any (unsolicited) superior alternative proposals received by Spider. Spider announced that it would hold the shareholder meeting to approve the combination on July 8, 2010, two days after Cliffs' offer was to expire.

Cliffs Increases, KWG Matches. On June 14, Cliffs proposed to increase its offer from $0.13 to $0.165 cash per share, subject to certain conditions. The special committee of the Spider board and the board determined that Cliffs' $0.165 proposal constituted a "superior proposal" under the agreement with KWG, which triggered KWG's five-day matching right. On June 23, KWG agreed to match Cliffs' proposal for $0.165 per Spider share. As a result, the Spider board informed Cliffs that its revised offer of $0.165 per share was no longer "superior".

Cliffs Raises Again. On June 25, Cliffs proposed to further increase its offer to $0.19 cash per share. That proposal was determined by the Spider special committee and Spider board to be a "superior proposal", and KWG had a further matching right that would expire on July 6, 2010 at 12:01 a.m. (Eastern Time).

The Decision

At the time of the hearing, Cliffs' offer was scheduled to expire prior to the shareholder meeting to consider the KWG merger. Unless the Cliffs offer were extended the continued existence of the Spider rights plan would result in a failure of a condition to the "superior" Cliffs offer, and therefore possibly deny shareholders the opportunity to accept it.

At the hearing, Cliffs submitted that the Spider rights plan had accomplished its purpose in allowing for an auction and should be set aside to allow Spider shareholders to "choose the way forward". In support of this argument Cliffs pointed out, among other things, that by the expiry date of its offer:

- Spider had agreed not to seek out some other transaction, foreclosing or dramatically reducing the possibility of other bidders emerging, and
- an auction process had occurred, as a result of which Cliffs' offer premium had increased from 62.5% to 106% (and ultimately to 138%).

The OSC decided not to cease trade the Spider rights plan. The panel indicated that Cliffs' application was premature "considering all the circumstances, and in particular, the ongoing auction between Cliffs and KWG for Spider".

Historically Canadian securities regulators have generally not permitted rights plans to survive in the midst of an auction. In Re Falconbridge Limited, Falconbridge was allowed to keep a shareholder rights plan in place during an auction for a limited period of time primarily as a result of the OSC's concern that failing to do so might result in Falconbridge shareholders being faced with a potentially coercive partial bid. Spider's shareholders did not face a similar risk.

In this context, it is unclear why Spider shareholders should be denied the choice of being able to accept Cliffs' offer and suggests that a concern other than coercion may have driven the decision.

The Outcome for Spider

On July 2 –after the OSC hearing – KWG informed Spider that KWG would not exercise its matching right, and the Spider board confirmed that Cliffs' proposal was "superior". As a result, Spider terminated its agreement with KWG (paying a break fee), cancelled the meeting of Spider shareholders to consider and vote on the combination with KWG and entered into a support agreement with Cliffs.

On July 6, the special committee and the board announced that all of the conditions to Cliffs' offer had been satisfied or waived. Cliffs then took up the approximately 316 million common shares of Spider that were validly tendered, resulting in Cliffs owning approximately 52.1% of the Spider shares then outstanding on a fully-diluted basis. Cliffs extended the offer to 11:59 p.m. (Eastern Time) on July 16, 2010.

Implications of the Decision

The Spider decision may suggest an increasing reluctance on the part of the OSC to intervene to cease trade a rights plan. Such a view might appear to be consistent with the decision of the OSC in Neo and the Alberta Securities Commission in Pulse Data. However, the decision would appear to be inconsistent with the views expressed by the British Columbia Securities Commission in April in its decision in Lions Gate – although the reasons of the BCSC also are yet to be issued – and inconsistent too with prior decisions. In the absence of guidance that may be provided by the reasons, and in light of other recent "pill" decisions, the OSC has made it increasingly difficult to advise acquirors or targets as to the likely outcome of a "pill" hearing.

Please contact any member of Goodmans' Corporate Securities Group to discuss this decision.

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