Goodmans LLP

Hostile Take-Over Bids in Canada

In Canada, as in the U.S., take-over bids (tender offers) can be used by potential acquirors to take a 'hostile' or unsolicited offer to purchase a public company directly to shareholders, bypassing the target board. Although the general framework for regulating hostile bids is similar in both countries, there are several differences that make Canada a more 'bidder friendly' jurisdiction. The summary below provides an overview of certain key considerations relevant to hostile take-over bids in Canada.

Making a Take-Over Bid in Canada

General

In Canada, the rules regulating take-over bids are triggered when a bidder's offer to acquire crosses a 'bright line' 20% ownership threshold. For purposes of the ownership threshold, the bidder's holdings are considered to include (i) securities beneficially owned by the bidder or any person acting jointly or in concert with the bidder and (ii) securities that may be converted or exchanged within 60 days into the class of securities subject to the bid. If the formal take-over bid rules are triggered, the bidder must follow a prescribed process to launch and pursue the bid.

However, there are a number of exemptions from the formal take-over bid requirements available to acquirors including:

- *private agreement exemption* - an offer made through private agreements with not more than five shareholders and at a price, including brokerage fees or commissions, not exceeding 115% of the market price;
- *normal course purchase exemption* - an offer for not more than 5% of the equity securities of the target completed by way of ordinary course market purchases; and
- *foreign take-over bid exemption* - an offer made where, subject to certain conditions (i) security holders in Canada beneficially own less than 10% of the outstanding securities of the class subject to the bid and (ii) the greatest dollar volume of trading in such securities during the last 12 months occurred on a stock exchange outside of Canada.

Launching a Bid

- A take-over bid may be launched by:

  - mailing a take-over bid circular to the target shareholders; or

  - publishing an advertisement briefly summarizing the bid and concurrently publicly filing the take-over bid circular.

- Given that hostile bidders rarely have advance access to the target's shareholder list, almost every hostile bid is launched by advertisement.
- In the absence of an exemption, a take-over bid must, among other things:

  - be made to all of the target shareholders by way of a formal take-over bid circular;

- stay open for acceptance for at least 105 days unless abridged by the target board (to not less than 35 days);

- require that at least 50% of all outstanding target shares (other than those held by the bidder) be tendered before the bidder can take up any shares under the bid;

- if the majority tender condition is satisfied and the bidder proceeds to take up shares, be extended for an extra ten days to allow additional 'follow on' tenders;

- offer identical consideration (i.e., no collateral agreements, subject to certain exceptions) or an identical choice of consideration to all holders of the same class of securities; and

- not be conditional upon the bidder obtaining financing.

Take-Over Bid Circular and Directors' Circular

- The bidder must send a take-over bid circular containing prescribed disclosure to all target shareholders. If the consideration offered to the target shareholders includes securities, the circular must include prospectus-level disclosure in respect of the bidder.
- If there are more than a *de minimus* number of shareholders in Quebec, the take-over bid circular must be translated into French.
- A take-over bid circular is not subject to prior review by Canadian securities regulators, even if the consideration includes securities of the bidder. If a circular contains a misrepresentation, there are civil rights of action for rescission or damages.
- Directors of the target must respond to a take-over bid within 15 days from the date of the bid by preparing and sending a directors' circular to all target shareholders. The directors must include in the circular a recommendation on the bid and reasons for the recommendation or a statement that no recommendation is made and the reasons for the statement.

Completing a Bid

- If there is a variation in the terms of the bid, the bidder must promptly issue and file a news release and mail and file a notice of the variation. Any variation in the terms of a bid gives rise to a 10-day extension of withdrawal and deposit rights of the target shareholders, subject to certain limited exceptions.
- If the bid is a partial bid, securities deposited to the bid must be taken up by the bidder on a *pro rata* basis.
- If all conditions of the bid have been complied with or waived (other than the majority tender condition, which cannot be waived), the bidder must take up and pay for securities deposited under the bid as soon as possible after the expiry of the bid and, in any event, not later than three business days after the securities deposited under the bid are taken up.
- Target shareholders may generally withdraw securities deposited under the bid at any time until the securities are taken up by the bidder or if the securities have not been paid for within three business days of being taken up.
- The bidder may acquire any securities that were not tendered to the bid by:

  - utilizing statutory compulsory acquisition procedures, if at least 90% of the securities not owned by the bidder or its affiliates are acquired pursuant to the bid and the compulsory acquisition takes place within the 120 days of the launch of the bid; or

  - a second step 'squeeze out' transaction, if less than 90% but at least two-thirds of the securities not owned by the bidder or its affiliates are acquired pursuant to the bid.
- As a result, most take-over bids are subject to a two-thirds minimum tender condition.

Pre-Bid Integration, Post-Bid Integration and Acquisitions During a Bid

- Under Canadian securities law, a take-over bid must be made at the best price paid for, and the highest percentage of securities taken up, under any pre-bid purchase made by the bidder of the class of securities to which the bid relates where:

  - the pre-bid purchase is not generally available on identical terms to all shareholders (this means that securities acquired by way of ordinary course market purchases will not trigger pre-bid integration); and

  - the pre-bid purchase occurs within the 90-day period immediately preceding the bid.

- A bidder cannot acquire securities of a class (or options to acquire those securities) that were the subject of a bid during the 20 business days following the bid's expiry unless the transaction is generally available to all holders of the securities sought and the securities are acquired on the same terms as those offered to shareholders under the bid.

- Acquisitions during the bid are generally limited to purchases of up to 5% through stock exchange trades only if the bidder has disclosed its intention to do so in its take-over bid circular.

Accumulating a Position

Canadian Take-Over Bid Requirements Accommodate Accumulations of Meaningful Toehold Positions

- In light of the 20% 'bright line' threshold for triggering the formal take-over bid requirements, a bidder can acquire up to 19.9% of the outstanding securities of a Canadian public company without having to make a formal bid; or

- provided the shares are acquired in compliance with an exemption (such as the 'private agreement' exemption described above), in the absence of a shareholder rights plan, 20%+ of the outstanding securities without making a formal bid.

- However, when considering its approach for accumulating a position, the bidder must be mindful of:

  - pre-bid integration (shares acquired by way of the 'private agreement' exemption within 90 days of commencing a bid will trigger pre-bid integration);

  - disclosure obligations, which, as noted below, generally apply once the bidder owns 10% of the outstanding shares;

  - the fact that, unlike in the U.S., in Canada, only shares acquired during a bid may be counted to determine whether the bidder is entitled to use statutory compulsory acquisition procedures following the bid, or is eligible to vote on the requisite 'majority of the minority' approval for a second step 'squeeze out' transaction; and

  - the impact that shares acquired prior to launching a bid has on the number of shares that must be tendered in order to satisfy the mandatory majority tender requirement.

Reporting Obligations

Early Warning Reporting is Not Required Until 10% Threshold Has Been Reached

- Canada has an 'early warning' disclosure system that is similar to 13D reporting requirements in the U.S.

- However, in contrast to the 13D regime, reporting is not required until the acquisition of ownership or control or direction (individually or with joint actors) of voting or equity securities that constitute 10% or more of the outstanding equity securities of any class on a partially diluted basis (reduced to 5% when a take-over bid is in progress).

- Derivatives and other arrangements that affect an acquiror's economic interest in the target do not independently trigger early warning reporting requirements but are required to be disclosed if an early warning report is otherwise required.

- Upon reaching the 10% threshold, an acquiror must, not later than the opening of trading on the next business day, issue a press release disclosing, among other things, its identity, ownership position and investment intent. An early warning report containing similar information must be filed with Canadian securities regulators within two business days of the date of the acquisitions.

- Additional reporting is required each time the acquiror acquires or disposes of another 2% or more of the relevant securities, if the acquiror's ownership position falls below 10%, or if there is any material change in information contained in a previously filed report.

- Once a reporting obligation has been triggered, the acquiror must refrain from purchasing additional securities until at least one business day after the early warning report is filed. This cooling off period does not apply if the acquiror owns more than 20%.

- There is an alternative monthly reporting system that is available to 'eligible institutional investors' (including investment managers that are registered under the U.S. *Investment Advisers Act of 1940* or are exempt from registration). However, an eligible institutional investor will be disqualified from using the alternative monthly reporting system if (i) it is soliciting proxies from the issuers shareholders in certain circumstances or (ii) it makes or intends to make a take-over bid for an issuer or proposes or intends to propose a business combination transaction that would give the investor effective control over the issuer.

- The alternative monthly reporting system reduces reporting requirements: (i) press releases are not required; (ii) reporting is done on a delayed basis (10 days after the end of the month in which a reporting threshold is crossed, as opposed to immediately after crossing the threshold); (iii) after the 10% threshold, reporting thresholds are in increments of factors of 2.5% instead of 2%; and (iv) the investor is exempt from the one business day moratorium on further acquisitions.

- If an eligible institutional investor initially qualifies to use the alternative monthly reporting system (i.e., it is not soliciting proxies or does not have an intention to make a take-over bid at that time) and later becomes disqualified, the investor must immediately issue and file a press release and file an early warning report within two business days of the press release.

Insider Trading

- All insiders of an issuer (including 10% shareholders, calculated on a partially diluted basis) must publicly disclose each trade of securities of the target by filing an 'insider report' within ten calendar days of the initial trade and then within five calendar days of any subsequent trade.

- Insider reports must disclose interests in derivatives and other arrangements that affect an acquiror's economic interest in the target.

- Eligible institutional investors who utilize the alternative monthly reporting system for early warning disclosure are generally exempt from insider reporting obligations.

Regulatory Considerations

- The acquisition of 20%+ of the voting securities of a public company could trigger merger notification or review requirements under the *Competition Act* (Canada).

- The acquisition of 33.3%+ of the voting shares of a Canadian public company that carries on a business in Canada by a non-Canadian could trigger notification or review requirements under the *Investment Canada Act*. Acquisitions of cultural businesses or that may implicate national security concerns are subject to more stringent rules.
- Companies operating in certain regulated industries (e.g., banking, telecommunications, broadcasting, insurance) are subject to statutory limits on foreign ownership.

Defensive Tactics

General

In Canada, fiduciary duties of directors are similar to fiduciary duties in the U.S., except that in a change of control transaction, 'Revlon' duties do not apply. However, the propriety of defensive tactics is generally determined by Canadian securities regulators, not the courts, and in examining defensive tactics the securities regulators generally focus on how the tactics affect shareholders' ability to accept a bid. The National Policy concerning defensive tactics adopted by Canadian securities regulators does not impose a fixed code of conduct on target directors. The National Policy and decisions of Canadian regulators in respect of shareholder rights plans make it clear that securities regulators are prepared to nullify defensive tactics where they have determined that the tactics unduly interfere with the target shareholders' ability to accept a bid.

Poison Pills in Canada are of Less Significance than in the U.S.

- While targets may implement a number of defensive tactics to thwart a hostile bid, the most commonly used tactic in Canada has been traditionally the shareholder rights plan (or 'poison pill').
- Poison pills are generally accepted in Canada and, until recently, were commonly employed in response to an unsolicited take-over bid. However, unlike in the United States, Canadian poison pills cannot be used to '**just say no**' to an unsolicited offer.
- Recent changes to Canadian securities laws (including extending the minimum tender period to 105 days and imposing a mandatory non-waivable majority tender condition) have effectively given all issuers a 'statutory' poison pill – i.e., protections against unsolicited offers that mirror what used to be achieved by adopting a poison pill.
- Notwithstanding the recent regulatory developments poison pills still have some utility in protecting issuers against 'creeping' take-over bids - i.e., preventing acquirors from using exemptions from the take-over bid requirements to acquire more than 20% of the outstanding securities without making a formal bid to all shareholders.

About Goodmans

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