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Dealing with multiple personalities in M&A

By Neill May

Defensive tactics in the M&A world have a way of maintaining centre stage at all times, even when it appears that the hook has come out, the curtains have been drawn and the ushers are scraping gum off the seats. Amendments to the takeover bid rules earlier this year effectively neutered the utility of shareholder rights plans ("poison pills"). That might have pushed the topic off the front burner, but defensive tactics embody the spirit of that old saying: "If at first you don't succeed, maybe skydiving is not for you." In the wake of those rules changes, there has been increased focus on another potential form of defensive response to a hostile bid: private placements. That issue was at the centre of the recent joint decision of the Ontario and British Columbia securities regulators in connection with the proposed hostile bid by Hecla Mining Co. for Dolly Varden Silver Corp.

Private placements may sometimes be used as defensive tactics, but unlike poison pills, private placements have multiple personalities. I know something about multiple personalities; many people say that I have multiple personalities, and half of me believes them. The point is that, unlike rights plans, private placements serve purposes beyond simply blocking bids that may benefit a company and its stakeholders, mostly obviously raising funding that may be needed for corporate purposes. This raises the uneasy juxtaposition of corporate and securities laws as they apply to defensive tactics.

On the corporate side, directors of Canadian corporations owe a fiduciary duty to act in the best interests of the corporation. Our courts, applying the "business judgment rule," generally defer to a target board's decision to adopt defensive tactics if the decision is impartial, informed and within a range of reasonable alternatives. By contrast, Canadian securities regulators evaluate defensive tactics as part of their mandate to protect the public interest, seeking to intervene where there is conduct that is considered to be abusive of shareholders or of the capital markets. The securities regulators' approach in this context is guided by regulatory policy that prioritizes shareholder choice, meaning the opportunity to tender to a takeover bid. Historically, challenges to poison pills have been made to the securities regulators (because bidders like predisposition to shareholder rights) rather than to the courts. But because private placements can more directly involve corporate interests, the corporate law paradigm looms larger.

Private placements as defensive tactics is not a new phenomenon, though they have been far less common than poison pills. Regulators and courts have, in addressing these cases, balanced (sometimes in ways difficult to reconcile) the issues raised by private placements in the context of a bid. Some of those issues are similar to poison pill considerations, such as the effect on shareholder choice (do the placements deprive shareholders of an opportunity to tender to a bid or do they generate other possibly better bids?). Other aspects, however, are unique to private placements. For example, does the corporation have a genuine need for the capital raised? Does it matter that there are other regulators more actively involved, given that stock exchanges take an active role in policing private placements? And perhaps most vexingly, how to deal with problematic private placements, given the awkwardness of remedies (unlike a poison pill, which can be effectively terminated, a private placement may have to be reversed, and private placements can be completed very quickly).

These were the key issues at play in the proceedings concerning the Hecla bid for Dolly Varden. In that case, after Dolly Varden publicly disclosed its plan to repay a loan from Hecla and to ultimately reduce its debt with equity capital, Hecla announced its intention to make a bid. After Dolly Varden then announced a proposed significant private placement to repay debt and for other corporate purposes, Hecla complained to the regulators.

In their submissions, staff at the BCSC and OSC encouraged the adoption of a framework for regulating private placements that recognizes their potential dual role as a *bona fide* financing source and a defensive tactic. A number of potential factors were proposed, including timing (whether the placement was proposed before the bid or only afterward, in response to the bid), whether the target had a genuine need for the cash and whether shareholders would be effectively deprived of an opportunity to respond to a bid.

Ultimately, the regulators declined to intervene in that case. Until written reasons are released, it will be unclear how the regulators reached that decision, what factors were considered and how they were balanced. In one sense, this analysis will determine how to balance two aspects of defensive private placement's multiple personalities, the bid-deterring defensive element and the capital-raising aspect. Just as I have to deal with my own multiple personalities. No I don't. CL

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