

Mergers and Acquisitions Law

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OSC and BCSC Permit Dolly Varden Private Placement Impeding Hecla Mining Take-Over Bid

On July 25, 2016, the Ontario Securities Commission (OSC) and British Columbia Securities Commission (BCSC) publicly released a joint order permitting Dolly Varden Silver Corp. (TSX.V: DV) (“**Dolly Varden**”) to complete a private placement that had the effect of impeding an unsolicited take-over bid by Idaho-based Hecla Mining Co. (“**Hecla**”). The proceedings were closely watched by legal advisors and other market participants as the Hecla bid was the first unsolicited bid launched in Canada since the recent amendments to Canada’s take-over bid regime took effect. It also provided securities regulators with an opportunity to consider how their “public interest” jurisdiction (and in particular National Policy 62-202 - *Take-Over Bids - Defensive Tactics* (“**NP 62-202**”)) applies to a private placement that could impact a take-over bid under the new bid regime.

Recent Amendments to the Take-Over Bid Regime and the Role of Private Placements

On May 9, 2016, the rules applicable to take-over bids in Canada were amended to require all non-exempt bids to, among other things:

- remain open for a minimum period of 105 days (unless the target board reduces that period to a minimum of 35 days); and
- receive tenders of more than 50% of the shares subject to the bid (excluding shares owned by the bidder).

These amendments effectively render the primary tool historically used by target boards - the shareholder rights plan or “poison pill” - irrelevant as a tactical response to a hostile bid (because, unlike in the U.S., rights plans in Canada generally can only be used to delay - not prevent - a take-over bid that is made to all shareholders). As a result, there has been an increased focus on the potential use of private placements as part of target boards’ responses to hostile bids, as discussed in detail in our May 9, 2016 Article, *The Role of Private Placements in Canada’s New Take-Over Bid Regime*.

While a long line of decisions regarding the application of NP 62-202 to shareholder rights plans demonstrated that, absent extremely unique circumstances, there would ultimately come a time “when the pill must go” (i.e., it would be cease-traded by regulators), the framework for tactical private placements has been less clear. Regulating private placements as potential defensive tactics gives rise to a number of challenges that did not exist in the rights plan context, including the fact that, unlike rights plans (that were often used solely as a defensive tactic), private placements can provide other benefits to a target and its shareholders, including the potential to achieve *bona fide* business objectives or attract a superior bid. *Dolly Varden* forced the OSC and BCSC to confront this and other challenges in the context of the new bid regime.

The Dolly Varden Proceedings

Hecla became a significant shareholder and insider of Dolly Varden in 2012 when it acquired 19.9% of Dolly Varden’s outstanding shares. At that time, Hecla appointed one representative to Dolly Varden’s board of directors who ultimately became Dolly Varden’s current (Interim) Chief Executive Officer.

Goodman's^{LLP} Update

The point in time, if any, at which this individual ceased to be a “representative” of Hecla was a contested fact that was important in determining whether Hecla was required to obtain an independent formal valuation of Dolly Varden’s shares in connection with its bid.

In September 2015, Hecla (and another Dolly Varden shareholder) provided Dolly Varden with a \$1.5 million loan. As a result of certain restrictions in the Hecla loan and challenges in the relationship between Dolly Varden and Hecla, Dolly Varden announced, on June 13, 2016, its intention to (a) replace the Hecla loan with a new \$2.5 million loan, and (b) ultimately repay the new loan with equity.

On June 27, 2016, Hecla announced its intention to make a take-over bid for all of the outstanding Dolly Varden shares at a price of \$0.69 per share, representing a premium of 55% to the closing price of Dolly Varden’s shares on June 24, 2016 of \$0.45.

On July 4, 2016, Dolly Varden repaid the Hecla loan with the proceeds of the new loan. The next day, Dolly Varden announced its intention to raise additional capital to repay the outstanding balance of the new loan and for exploration and working capital purposes through a \$6 million private placement (consisting of up to 7,258,064 shares at \$0.62 per share and up to 2,142,857 “flow-through shares” at \$0.70 per flow-through share) that would result in potential dilution of up to approximately 42%.

Hecla formally launched its bid on July 8, 2016 on the condition, among others, that Dolly Varden’s proposed private placement not be completed. That same day Hecla filed an application with the BCSC (and subsequently the OSC) for an order, among other things, cease-trading the private placement.

Subsequently, Dolly Varden filed applications with the OSC and BCSC for orders compelling Hecla to, among other things, obtain an independent formal valuation (required under Multilateral Instrument 61-101 - *Protection of Minority Security Holders in Special Transactions* (“MI 61-101”) for all take-over bids by insiders, unless an exemption is available) of the Dolly Varden shares.

The Private Placement

In its application, Hecla argued that the private placement was undertaken primarily to frustrate the Hecla bid and would have the effect of denying Dolly Varden’s shareholders the ability to tender to the bid (by making it materially more difficult for Hecla to satisfy the new statutory 50% minimum tender condition) thereby directly engaging the policy concerns that NP 62-202 was intended to address. Dolly Varden argued that the private placement was solely intended to achieve the *bona fide* business purpose of reducing Dolly Varden’s debt and financing exploration activities and working capital requirements.

In their submissions, Staff of the OSC and BCSC encouraged the adoption of a new framework for regulating private placements that recognizes their potential dual role as both a *bona fide* financing source and a defensive tactic. Under this approach, the outcome in any particular case would involve the evaluation of a number of relevant factors, with no single factor necessarily being determinative. While Staff submitted a number of potential factors that could be relevant, the key factors in most cases are expected to be:

- whether the private placement was announced in response to, or in anticipation of, a bid,
- whether the target had a serious and immediate need for financing or the private placement would otherwise benefit target shareholders (e.g., by attracting a better offer), and
- whether the private placement would effectively deprive shareholders of the ability to tender to a bid.

In this case, Staff urged the commissions to not cease trade the private placement and, in doing so, placed significant weight on the fact that the intention to pursue a private placement (though notably not the specific terms, including size or price) was conceived by Dolly Varden’s board before it knew that Hecla intended to make a bid. Staff also submitted that the evidence demonstrated that Dolly Varden was in serious financial difficulty and had an immediate need for capital.

Goodmans^{LLP} Update

It will be important to see how much weight the commissions placed on these facts in reaching their decision. If, as Staff suggested, the timing of the private placement was the most influential factor in their decision, it could significantly limit the application of *Dolly Varden* to future cases, and leave open the important question of whether private placements can be initiated by a target board *in response* to a bid. On the other hand, if the commissions accept that a private placement can be implemented in response to (or in anticipation of) a bid so long as the target has an immediate *bona fide* financing need, the decision may provide broader scope for target boards to utilize private placements even if a bid has already been announced or is pending.

The Formal Valuation

In their joint order, the OSC and BCSC also ordered Hecla to obtain, at its own expense, a formal valuation of Dolly Varden's shares in accordance with MI 61-101. In doing so, the commissions implicitly held that Hecla failed to discharge its burden of proving that it could rely on a valuation exemption available to an offeror that, among other things, did not have board or management representation within the preceding 12 months, or knowledge of any undisclosed material information concerning the target. While the scope of this aspect of the order will be clarified in the commissions' reasons, the order also appears to reinforce securities regulators' policy of requiring strict adherence to the requirements of MI 61-101, even in circumstances where the value to shareholders of an independent formal valuation is less clear (such as, in

this case, where the target priced a substantial private placement in close proximity to the launch of the insider bid). In this regard, it is noteworthy that the "auction" exemption from the formal valuation requirement for insider bids can only be engaged by a third party acquisition transaction and does not apply in the context of a private placement.

Conclusions

Until the commissions' written reasons are released, the role private placements will play in the new take-over bid regime, and the extent to which they can be adopted in response to, or in anticipation of, a take-over bid, will remain unclear. Nevertheless, the commissions' order demonstrates that private placements have the potential to significantly impact a hostile take-over bid (the Hecla bid was formally withdrawn within hours of the commissions' order becoming public), and that the regulation of private placements is likely to be more difficult than rights plans given the need to balance the legitimate interest of public companies in raising capital against the policy considerations embodied in NP 62-202 (that a target's shareholders should make the ultimate decision about whether a take-over bid can proceed). Whether the case will establish a new paradigm, or will simply be a fact-driven outcome, however, remains to be seen.

Please contact any member of our Corporate Securities Group to discuss the implications of this case and for more information about the potential use of private placements in the context of hostile take-over bids.