

## Corporate Securities

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### OSC Writes Another Chapter on Poison Pills

The recent skirmish over control of Chapters Inc. gave the Ontario Securities Commission another opportunity to further define the parameters of acceptable uses of shareholder rights plans (or “poison pills”) by targets of unsolicited take-over bids.

#### Introduction

In March 2000, Gerald Schwartz (the Chairman and CEO of Onex and husband of Heather Reisman of Indigo Books & Music Inc.) approached the CEO of Chapters to discuss a “friendly merger” of Chapters and Indigo. In that context, on April 16, 2000 the board of Chapters adopted a shareholders rights plan that was confirmed by the company’s shareholders on September 13, 2000.

#### Chapter 1 - The Trilogy Bid

In late November 2000, Trilogy Enterprises Inc. (a company controlled by Mr. Schwartz and his wife) launched a \$13 per share hostile bid for control of Chapters.

#### Chapter 2 - The Search for the White Knight

Chapters, together with its financial advisor, NM Rothschild & Sons Limited, immediately began its search for a “white knight”. More than 50 days later, on January 18, 2001, Chapters announced a “friendly” \$16 per share deal with Future Shop. Management of Chapters (holding about 30% of the company’s shares) “locked-up” to the Future Shop transaction.

The Future Shop transaction required Chapters to keep its rights plan in place until Future Shop was in a position to take-up and pay for Chapters shares under its bid. At that time, the rights plan would have been waived for all bids that were outstanding. This requirement would have had the effect of placing the Trilogy and Future Shop bids on a more equal footing in terms of their timing. Chapters agreed to waive the plan in respect of Future Shop’s bid (only) when Future Shop was in a position to take up and pay for shares. In effect, Future Shop was given the right to determine the timing of all bids.

#### Chapter 3 - Trilogy ‘Ups the Ante’

In response to the Future Shop proposal, on January 20, 2001, Trilogy announced that it intended to increase its offer to \$17 per share. Trilogy said that it had no intention of extending its current \$13 per share bid beyond its January 24, 2001 expiration date or sweetening its bid unless the Chapters rights plan was cease traded by the OSC.

#### Chapter 4 - Must the Pill Go?

On January 21, 2001, Trilogy, Chapters and Future Shop appeared before the OSC to consider Trilogy’s request that the Chapters rights plan be cease traded. In response, Chapters argued the pill should remain in place so Future Shop could mail its offer, thus providing shareholders with a “real choice”. Future Shop asked the OSC to extend the pill for an additional 38 days.

The OSC approached the matter in what has become its traditional manner. The panel reiterated its guiding principles that:

- “There comes a time when the pill has to go”: the question is not whether, but when.
- There is a natural tension between the objectives of letting the shareholders decide for themselves and of letting management and the board fulfil what they see as their fiduciary duties.
- If there appears to be a reasonable possibility that, given a reasonable period of time, the board of the target can increase shareholder choice and maximize shareholder value, absent some other compelling reason requiring the termination of the plan in the interest of shareholders, a plan should be allowed to function for that further period, so as to permit the directors of the target to fulfil their fiduciary duties.
- In each case, the analysis will be fact-specific.

In the case of the Chapters pill, the panel indicated that the principal factors that were relevant in its determination that “it was time for the pill to go” were that:

- The rights plan was adopted by Chapters’ board and confirmed by its shareholders after Mr. Schwartz initially expressed an interest in a merger of Chapters and Indigo.
- In light of the support agreement and lock-ups in favour of the Future Shop transaction, it appeared that Chapters was no longer seeking alternative transactions.
- There was no demonstration of broad shareholder support for the continuance of the pill, and in fact two institutional shareholders indicated that they wished to be free to tender to the Trilogy bid.
- As Chapters was neither large in size nor complex in nature, it should not take an unusually long period to canvass potential purchasers. Additionally, since Chapters and Indigo were the major players in the Canadian retail book industry, the likely absence of

synergies with companies outside of the industry suggested there would be few potential, viable offers.

- Chapters had engaged in a number of “defensive tactics”.
- 54 days had elapsed since Trilogy first announced its bid.

In this context, the OSC concluded there was no reasonable possibility that, given a reasonable period of time, the Chapters board would be able to increase shareholder choice or value. Moreover, the OSC was satisfied that Chapters shareholders would not receive the benefit of Trilogy’s enhanced \$17 per share offer unless the Chapters poison pill was cease traded. The OSC was of the view that it would be highly unlikely for a competing bidder like Trilogy to continue its offer for the extended period that Future Shop had required.

The OSC also noted that, notwithstanding National Policy Statement No. 62-202 states that an objective of the take-over bid provisions of Canadian securities legislation “is to provide a regulatory framework within which bids may proceed in an open and even-handed environment”, this does not mean that competing bids need be open to shareholders simultaneously. The Commission was not inclined to interfere to equalize the expiry dates for existing and potential bidders - which would result in a situation where the last bidder would dictate the timing for all previous bidders. In the OSC’s view, this approach would have a detrimental effect on the bidding process and is not contemplated by the legislative regime.

With this background, the OSC also noted that “equalization of timing” was not one of the purposes of the Chapters rights plan. Equalization of timing between bids was not a rationale put forwarded for the plan when shareholder approval was sought. The Commission concluded that it would be inappropriate to maintain the plan “for a purpose for which it was not designed”.

The OSC thus ordered the Chapters rights plan be cease traded.

**Epilogue**

With the Chapters rights plan cease traded, Trilogy was successful in acquiring control of Chapters under its enhanced \$17 per share bid.

The Chapters decision has potentially significant implications for every issuer that is, or may be, a target or initiator of an unsolicited bid. We invite you to contact the experienced M&A team at Goodmans to discuss these implications.

**Toronto**

<b>Allan Goodman</b>	416.597.4243
agoodman@goodmans.ca	
<b>Francesca Guolo</b>	416.597.4159
fguolo@goodmans.ca	
<b>Stephen Halperin</b>	416.597.4115
shalperin@goodmans.ca	
<b>Tim Heeney</b>	416.597.4195
theeney@goodmans.ca	
<b>Jonathan Lampe</b>	416.597.4128
jlampe@goodmans.ca	
<b>Dale Lastman</b>	416.597.4129
dlastman@goodmans.ca	

<b>David Matlow</b>	416.597.4147
dmatlow@goodmans.ca	
<b>Neill May</b>	416.597.4187
nmay@goodmans.ca	
<b>William Rosenfeld</b>	416.597.4145
wrosenfeld@goodmans.ca	
<b>Neil Sheehy</b>	416.597.4229
nsheehy@goodmans.ca	
<b>Jeffrey Singer</b>	416.597.4283
jsinger@goodmans.ca	
<b>Kenneth Wiener</b>	416.597.4106
kwiener@goodmans.ca	

**Vancouver**

<b>Paul Goldman</b>	604.608.4550
pgoldman@goodmans.ca	
<b>Steven Robertson</b>	604.608.4552
srobertson@goodmans.ca	
<b>Bruce Wright</b>	604.608.4551
bwright@goodmans.ca	

**Hong Kong**

<b>Leo Seewald</b>	852.2522.1061
lseewald@goodmans.ca	

Requests for additional copies of this communication or changes of address  
should be directed to Sandy Mitchell at [smitchell@goodmans.ca](mailto:smitchell@goodmans.ca)

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