Securities Law Newsletter
December 2012
Westlaw Canada

PRIVATE PLACEMENTS BY ACQUISITION TARGETS – ANOTHER REGULATORY GREY AREA

Ralph Shay, Fraser Milner Casgrain LLP

British Columbia Securities Commission Decision on Inmet Mining and Petaquilla Minerals

On November 28, 2012, the British Columbia Securities Commission (BCSC) issued the reasons for the decision it had made following a hearing to consider an application made by Inmet Mining Corporation for certain relief in connection with its hostile take-over bid for Petaquilla Minerals Ltd. The hearing had concluded with an unsurprising order to the effect that Petaquilla's shareholder rights plan would be cease traded on a specified date unless Petaquilla waived the plan as against Inmet's bid. What was less predictable was that the BCSC also cease traded a proposed private placement note financing by Petaquilla, unless Inmet did not purchase any Petaquilla shares under its bid.

Petaquilla had publicly announced its intended note offering approximately seven weeks before the announcement of Inmet's take-over bid. There was no indication in the BCSC's reasons or in the public record that the note offering proposal had been initiated as a take-over defensive tactic. In fact, the BCSC stated that it appeared from the evidence that "the proposed offering was in the ordinary course of business. Certainly there was no evidence that it was an artificial transaction created as a purely defensive measure."

The BCSC reasoned that "regardless of Petaquilla's primary motive for the notes offering", the offering could potentially prevent Inmet's take-over bid from being completed, given that the bid was conditional on Petaquilla not having completed or entered into any binding agreement with respect to the note offering. The evidence indicated to the BCSC that Inmet regarded the note offering as a threat to Petaquilla's financial stability, and there was the possibility of the offering including warrants, representing a substantial dilution risk to Inmet.

While it is repeatedly stated by securities regulators that decisions based on their public interest jurisdiction turn on their own facts, the reasons in the Petaquilla case appear to indicate that any significant transaction a public company proposes has at least the potential of being challenged successfully at a later time by a hostile bidder at a securities regulatory proceeding on the basis that the transaction would prevent the take-over bid from being completed. This possibility appears to exist even if the target makes the decision to undertake the transaction without any contemplation of a take-over bid.

According to the BCSC's reasons, evidence at the hearing showed that a number of details relating to the note offering were yet to be determined, and that the cease trading of the note offering would have no adverse impact on Petaquilla during the short period of time between the hearing and the expiry of Inmet's take-over bid. In addition, the reasons included references to testimony at the hearing of Petaquilla's chief executive officer "that the Petaquilla board was not prepared to rule out an attempted completion of the notes offering as a defensive tactic" and that Petaquilla did not have an immediate need for the financing. Nevertheless, the reasons taken as a whole suggest that the note offering would have been cease traded regardless of the existence of any defensive tactic element. The decision appeared to be based primarily on the potential effect of the note offering on the bid, irrespective of Petaquilla's motivation for the offering. In its explanation for its decision to cease trade the note offering, the BCSC made no reference to National Policy 62-202 – *Take-over Bids – Defensive Tactics* (NP 62-202). This omission is consistent with an interpretation of the decision as one that goes beyond the principles set out in NP 62-202.

Private Placement as an Alleged Defensive Tactic

It is not uncommon for a Canadian public company to consider undertaking a financing transaction during a time when there have been indications that a proposed offer to acquire the company might be under consideration by one or more potential suitors. If an actual bid has not yet materialized and there is a business rationale for the financing that can be reasonably articulated (other than solely to make an acquisition of the company by an unfriendly bidder more difficult), the company is generally considered to be on a solid footing from a purely legal standpoint if it proceeds with the financing. This is due in large part to the Canadian courts' demonstrated deference to decisions of company management under the business judgment rule. However, the public interest jurisdiction of the securities regulators, and in particular NP 62-202, makes a financing that is perceived to hinder a possible take-over bid open to a regulatory challenge, the outcome of which can not be predicted with any degree of certainty.

The guidance on the judicial view of the private placement as an alleged defensive tactic comes mainly from British Columbia. In the 2010 case of *Icahn Partners LP v. Lions Gate Entertainment Corp.*, the Supreme Court of British Columbia dismissed an oppression action concerning a private placement that was allegedly used as a defensive tactic to a take-over bid proposed by the petitioner in the proceeding. In support of its decision, the court cited the 1972 case of *Teck v. Millar*, also a decision of the Supreme Court of British Columbia, in which a share issuance that was undertaken to prevent a particular party from obtaining control of the issuing company was upheld. The judicial position in *Icahn* can be conveniently summarized by the following statement by the British Columbia Court of Appeal in its 2011 reasons for dismissing the appeal of the Supreme Court's decision:

> In Canada, it has been clear since *Teck* that where directors have carried out reasonable enquiries to inform themselves as to where their company's best interests lie and are *bona fide* of the belief, based on reasonable grounds, that a proposed takeover will run contrary to those interests, they are entitled to use their powers to take defensive measures.

Based on what little judicial evidence there is from Canadian courts, it would appear that target boards have an advantage over hostile bidders when it comes to alleged take-over defensive tactics that are challenged at the court level. While there have been bidder-friendly judgments over the last 30 years – for example, *Exco Corp. v. Nova Scotia Savings and Loan Co.* (Nova Scotia Supreme Court, 1987) and *Re*

347883 Alberta Ltd. and Producers Pipeline Inc. (Saskatchewan Court of Appeal, 1991) – on balance, decisions such as *Re Olympia & York Enterprises Ltd. and Hiram Walker Resources Ltd.* (Ontario High Court of Justice, 1986) and the above-noted *Icahn* are more consistent with the principles set out by the Supreme Court of Canada in *BCE Inc. v. 1976 Debentureholders*. That 2008 case did not involve a take-over defensive tactic, but it strongly confirmed the business judgment rule in the context of disputes involving an action taken by a company's board of directors in the context of a possible change of control of the company.

From the standpoint of securities regulators, it has been firmly established by the shareholder rights plan (poison pill) decisions that the business judgment rule is superseded by NP 62-202 insofar as take-over defensive tactics are concerned. In its list of transactions that may come under scrutiny if undertaken in the context of a take-over bid, NP 62-202 includes the issuance of securities representing a significant percentage of the outstanding securities of the target.

In *Icahn*, the bidder applied to the BCSC for relief under NP 62-202 on the basis of an allegation that a private placement by the target, which had already occurred at the time of the BCSC hearing to consider the application, was a take-over defensive tactic that should be subject to regulatory review. The BCSC decided not to grant relief, noting that court was the most efficient forum to resolve the issues.

In February 2012, the Quebec Bureau de décision et de révision (Bureau), a securities regulatory decision-making body, decided in *AbitibiBowater Inc. v. Fibrek Inc.* to issue a cease trade order against a proposed private placement by a take-over target. The target, Fibrek Inc., wished to obtain for its shareholders a competing, higher bid from a second bidder, Mercer International Inc., but due to the large number of Fibrek shares the first bidder, AbitibiBowater Inc., had locked up to its bid, a private placement by Fibrek to Mercer was necessary to provide Mercer with any chance of making a successful bid.

The Bureau used its public interest jurisdiction to issue the cease trade order. Among other reasons, the Bureau expressed the view that the purpose of an issuance of securities is to raise needed capital and that an issuance that has a dilutive effect in connection with a take-over bid should only be allowed if it is proved that the target has a real and immediate need for capital. This view was not shared by the Court of Quebec, which overturned the Bureau's decision on appeal. However, the Quebec Court of Appeal restored the Bureau's decision on further appeal, according the securities regulator the usual judicial deference. Leave to appeal to the Supreme Court of Canada was denied. If the Bureau had deferred to the court in *Fibrek*, as the BCSC did in *Icahn*, it is apparent that the outcome may have been different.

Private Placement in Conjunction with a Negotiated Business Combination

A proposed private placement of voting securities may also be subject to regulatory scrutiny if it is to a purchaser that proposes to subsequently acquire the issuing company, since the right of the privately placed securities to be voted in favour of the acquisition may be called into question. What little guidance that has been provided by the regulators on this subject has been inconclusive.

In the 2009 reasons for its decision in *Re HudBay Minerals Inc.*, the Ontario Securities Commission (OSC) commented on a private placement of shares of Lundin Mining Corporation to HudBay Minerals Inc. that was negotiated in conjunction with a proposed plan of arrangement under which HudBay would acquire Lundin. The private placement was not the subject of the OSC hearing, but in the final section of its reasons the OSC said the following:

> In our view, having very recently acquired those shares as part of a private placement connected to the [plan of arrangement], HudBay should not, as a matter of principle, be permitted to vote them in favour of the [plan of arrangement]… In our view, an acquirer should not generally be entitled, through a subscription for shares carried out in anticipation of a merger transaction, to significantly influence or affect the outcome of the vote on that transaction. The acquirer in a merger transaction has a fundamentally different interest in the outcome of the transaction than the shareholders of the target.

Later in the same year, the Alberta Securities Commission (ASC) considered this issue directly in *Re ARC Equity Management (Fund 4) Ltd.* In conjunction with a take-over bid and amalgamation proposal under which Paramount Energy Trust would acquire Profound Energy Inc., Profound issued special warrants to Paramount by way of a private placement. The special warrants were subsequently converted into common shares of Profound. A shareholder of Profound applied to the ASC for orders that would have the effect of preventing Paramount from voting those common shares in favour of the amalgamation.

Following a lengthy examination of the facts, the ASC, while giving consideration to *HudBay*, decided not to grant the requested relief, and Paramount was permitted to vote the shares obtained in the private placement in favour of the amalgamation. The ASC did not regard the commentary in question in HudBay as determinative, noting that it was obiter, made in the context of its own facts, and expressed only as a "view" as to what "generally" should occur.

Conclusion

The regulation of poison pills in Canada has been the subject of a certain degree of uncertainty due to some inconsistent decisions among the securities regulators over the past five years. At the present time, however, and subject to any changes that may be brought about by future regulatory decisions on contested matters or revisions to NP 62-202, the result of a typical poison pill dispute is not overly difficult to predict. The dispute will be settled by a securities regulator, not a court. A poison pill may be permitted by the securities regulator to remain in place for a short period of time if the target can demonstrate that it has a reasonable chance of procuring a better offer for shareholders within that time, but the pill will not be permitted to be used as a "just say no" defence to a hostile take-over bid. A possible (but not guaranteed) exception, which will not apply in the case of a hearing held in British Columbia, will be where the poison pill is approved by the target's shareholders at a meeting held during the hostile bid.

On the other hand, it has been demonstrated that dispositions of other disputes involving take-over bids or business combinations, such as issues relating to controversial private placements, lend themselves far less to predictability. For these matters, the outcomes that can be expected and, in some cases, the forums in which they will be addressed remain grey areas.