

M&A BuildingBlocks

Defensive Tactics – Shareholder Rights Plans

This instalment in our series of building blocks focuses on defensive tactics, and in particular, shareholder rights plans. Such plans may be adopted as a preventative measure when no transaction is pending or as a tactical measure in response to a hostile take-over bid.



Introduction

One of the most commonly used defensive tactics that Canadian boards of directors have used to prevent or fight a hostile bid is a shareholders rights plan.¹ A key purpose of a rights plan is to provide the target board with time to consider alternatives to the hostile bid. Canadian regulators have historically allowed boards to adopt and maintain a rights plan for a reasonable period of time (commonly up to 60 days) though have held that at some point, a plan will have served its purpose and should be cease traded.

In 2016, sweeping changes were made to Canadian take-over bid rules.² One of the most significant changes was to increase the minimum bid period from 35 to 105 days. As rights plans were typically cease traded after 60 days, many market participants questioned whether this would end the use of rights plans.

Despite these major changes to the take-over bid rules, many Canadian issuers continue to adopt shareholder approved rights plans. While these plans may no longer be needed to afford a board additional time should a hostile bid be made, they can be effective in preventing creeping bids, acquisitions of control through private transactions exempt from take-over bid rules or lock-ups that could preclude competing bids.

In 2017, CanniMed Therapeutics Inc. was the first Canadian issuer to adopt a tactical rights plan following adoption of the new rules. The Ontario and Saskatchewan securities commissions made it clear in early 2018 in *Re Aurora Cannabis Inc.*,³ that there will be a diminished utility of tactical shareholder rights plans in Canada. This case is discussed further below.



¹ Other defensive tactics that boards may consider include:

- seeking alternative transactions to the bid such as a competing offer from a friendly bidder or conducting a private placement which could either make the company more expensive to the bidder or place shares in the hands of friendly shareholders,
- attempting to persuade shareholders to reject the bid, or
- deterring the bidder from continuing with their bid either by selling off assets or commencing litigation.

² *Canadian securities regulators adopt fundamental changes to take-over bid regime*, Ontario Securities Commission, February 25, 2016, http://www.osc.gov.on.ca/en/NewsEvents_nr_20160225_changes-take-over-bid.htm.

³ *Aurora Cannabis Inc. (Re)*, 2018 ONSEC 10.

1 What is a Rights Plan?

The mechanics of a rights plan are fairly complex and nuanced. At a high level, rights plans generally provide that if a shareholder becomes a 20% shareholder of the target company, rights beneficially owned by all shareholders, other than the acquiring shareholder and its joint actors, are exercisable into common shares at a significant discount which would result in massive dilution to the acquiring person.

There are two types of rights plans; *shareholder approved plans* that are adopted as a preventative measure when there is no impending take-over bid, and which must be approved by shareholders within 6 months of adoption; and *tactical plans* which are adopted in response to an actual or threatened bid. Tactical plans are usually not put to a shareholder vote and become void 6 months after adoption.

2 Approval Process for a Rights Plan

A rights plan must be approved by the target board of directors. In the case of tactical plans, shareholder and ISS approvals are generally not sought. Further, while the plan must be filed with the TSX, the TSX will generally defer its review of a tactical plan until such time as a securities regulator has reviewed the plan. For non-tactical plans, TSX and shareholder approval will generally be sought. Further, many issuers will choose to obtain ISS approval for a plan which makes it more likely that shareholders will vote in its favour.

ISS has stated that it believes that the “new generation” of rights plans following adoption of the new take-over bid rules will continue to serve an important purpose in ensuring shareholders are treated equally in a control transaction by precluding creeping acquisitions or the acquisition of a control block through private agreements between a few large shareholders. As part of their recommendations, ISS states that a rights plan must be limited in scope to give a board additional time to find an alternative value-enhancing transaction and to ensure the equal treatment of all shareholders.

3 The Decision in Aurora Cannabis Inc.

Following CanniMed’s announcement to acquire Newstrike Resources Ltd., Aurora launched a hostile bid for CanniMed and announced that it had entered into lock-up agreements with CanniMed shareholders holding approximately 36% of CanniMed’s shares. The Aurora bid was conditional on, among other things, the Newstrike deal not proceeding, which deal was subject to approval by CanniMed shareholders.

In response to Aurora’s bid, CanniMed adopted a rights plan. Among other things, the plan prevented Aurora (or the locked-up shareholders) from acquiring shares that they otherwise could have voted against the Newstrike deal.

In cease trading CanniMed’s plan, the regulators commented that with the new rules in place, there will be very limited circumstances where they will not immediately cease trade a tactical plan. Despite the outcome in Aurora, CanniMed’s plan was effective as it prevented Aurora from purchasing additional shares before the Newstrike vote.

4 Implications Going Forward

We believe that issuers will continue to adopt shareholder approved rights plans for the reasons noted above. However, based on the decision in *Aurora*, tactical plans will likely be of limited use and adopted less frequently. We expect that such rights plans will only be adopted in unique circumstances where there may be a benefit to the target board in having a plan in place during the short period between adoption of the plan and the hearing at which the plan is cease traded.

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