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Contested private placements under the new take-over bid regime: the Dolly Varden decision

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In a significant decision, the British Columbia and Ontario securities commissions have upheld a contested private placement by the target of an unsolicited take-over bid where they concluded that there was a legitimate need for the financing and the private placement was not implemented as a defensive tactic in response to the bid. The securities commissions provided important guidance on the regulatory analysis and treatment of contested private placements in light of the traditional limitations on defensive tactics set forth in National Policy 62-202. The decision is notable in particular for its explicit acknowledgement of the importance of the fiduciary responsibilities and business judgment of boards of directors in this context and arguably exhibits a degree of deference to that judgment which has not often been seen on the part of Canadian securities regulators.

On October 24, 2016, the Ontario Securities Commission (OSC) and British Columbia Securities Commission (BCSC) (the Commissions) issued their joint reasons relating to the proposed private placement undertaken by Dolly Varden Silver Corporation in the context of an unsolicited take-over bid by Hecla Mining Company. Hecla challenged the private placement on the basis that it was an improper defensive tactic contrary to National Policy 62-202 *Take-Over Bids – Defensive Tactics* (NP 62-202), which militates in favour of shareholder choice.

As described in our earlier Osler Update, the OSC and BCSC released separate orders on July 25, 2016, dismissing the Hecla application seeking to cease trade the proposed private placement by Dolly Varden. The Ontario order also cease traded the Hecla take-over bid for Dolly Varden pending the obtaining and inclusion of a formal valuation in accordance with section 2.3 of Multilateral Instrument 61-101 – *Protection of Minority Security Holders in Special Transactions*. Hecla withdrew its bid for Dolly Varden later that day following the release of the OSC and BCSC orders.

Private placements resulting in the dilution of a significant shareholder or effected while a take-over bid is pending have been the subject of discussion both by courts and securities regulators over many years. Courts have tended to defer to the target board of directors' business judgment in deciding whether to proceed with a private placement, even when it was clear that it was in part designed to frustrate the intentions of a party seeking control of the target. Securities commissions, on the other hand, have been more willing to intervene in circumstances where they concluded that the private placement was entered into in the absence of a real need for financing (see, for example, the events surrounding Fibrek's response in 2011 to a hostile bid from Resolute). The decision in Dolly Varden is of particular interest because it is the first time securities regulators have waded back into these waters since the new Canadian take-over bid regime came into force earlier this year. While the decision provides important insight into the framework that securities regulators will use to

review and analyze challenges to private placements in the context of contested take-over bids going forward, the decision also reinforces the conclusions drawn in prior contested private placement decisions that the outcome of such cases will be highly fact specific and evidence dependent.

The decision

The *Dolly Varden* decision carefully sets forth the analytical framework for an evaluation of a private placement as an improper defensive tactic in the current context, including the need to now interpret NP 62-202 in light of the amendments to the Canadian take-over bid regime that came into effect this year. In this regard, the Commissions note that as the recent amendments represent "a material readjustment of the bid dynamics in favour of allowing target boards more time to respond to hostile bids and allowing for majority shareholder approval of bids," they expect that defensive tactics other than shareholder rights plans will become more common and will attract "a high level of regulatory scrutiny." At the same time, the Commissions cite with approval the Re Red Eagle and Re ARC Equity Management (Fund 4) Ltd. decisions of the BCSC and Alberta Securities Commission, respectively, to the effect that securities regulators should "tread warily in this area" and that private placements should generally only be blocked by securities regulators where there is "clear abuse" of the target shareholders and/or the capital markets.

In particular, the decision acknowledges that private placement transactions, unlike shareholder rights plans, may serve multiple corporate objectives. As such, in assessing private placements in the context of NP 62-202, there is an explicit acknowledgement of the need of securities regulators to balance: "(1) the extent to which the private placement serves bona fide corporate objectives, for which corporate law gives significant deference to a board of directors in exercising its business judgment, with (2) the securities law principles of facilitating shareholder choice with regard to corporate control transactions and promoting open and even-handed bid environments." The decision also acknowledges the overlapping roles of courts, securities regulators and stock exchanges with respect to the oversight of private placements in the bid context.

The Commissions then proceed to set forth a two-stage framework for assessing a private placement in the context of a take-over bid:

1. Does the evidence clearly establish that the private placement is not, in fact, a defensive tactic designed, in whole or in part, to alter the dynamics of the bid process?
2. If the private placement is or may be a defensive tactic, then the securities regulators would proceed to seek the appropriate balance between the shareholder protection principles of NP 62-202 and respect for a board's business judgment. The decision sets forth a "non-exhaustive" list of considerations relevant to assessing whether a private placement should be interfered with.

The two stages of this framework are discussed in more detail below.

Is the private placement a defensive tactic?

In assessing whether a private placement is a defensive tactic, the decision confirms that where it is established that the private placement will have a material impact on an existing take-over bid, the target will have the onus of establishing that the private placement was not used as a defensive tactic. The securities commissions may consider a variety of factors in determining the validity of a private placement, including the following:

- whether the target has a serious and immediate need for the financing;
- whether there is evidence of a bona fide, non-defensive business strategy adopted by the target; and
- whether the private placement has been planned or modified in response to, or in anticipation of, a take-over bid.

If the evidence demonstrates that the private placement is clearly not a defensive tactic, then the principles in NP 62-202 will not apply and the securities regulators would only need to consider whether there was some other reason for them to interfere with the private placement under the purview of their public interest jurisdiction.

Assessing private placements that are or may be defensive tactics

The decision then sets forth a list of additional non-exhaustive considerations that are relevant to the balancing exercise involved in determining whether the securities regulators should interfere with a private placement that is or may be a defensive tactic:

- Would the private placement otherwise be to the benefit of shareholders by, for example, allowing the target to continue its operations through the term of the bid or in allowing the board to engage in an auction process without unduly impairing the bid?
- To what extent does the private placement alter the pre-existing bid dynamics, for example, by depriving shareholders of the ability to tender to the bid?
- Are the investors in the private placement related parties to the target or is there other evidence that some or all of them will act in such a way as to enable the target's board to "just say no" to the bid or a competing bid?
- Is there any information available that indicates the views of the target shareholders with respect to the take-over bid and/or the private placement?
- Where a bid is underway as the private placement is being implemented, did the target's board appropriately consider the interplay between the private placement and the bid, including the effect of the resulting dilution on the bid and the need for financing?

The outcome in *Dolly Varden*

In applying these considerations to the facts in *Dolly Varden*, the OSC and BCSC determined as a factual matter that the evidence demonstrated that the private placement in question had been instituted for non-defensive business purposes, i.e., that the challenge was resolved under the first stage of the framework. In making that determination, the Commissions considered in detail the evidence presented regarding the timing, deliberations and negotiations relating to the private placement and regarding the issuer's financial context and need for the proceeds of the financing. The OSC and BCSC also noted that there was no evidence presented that the private placement was modified in response to the bid so as to become defensive in character.

Having determined that no NP 62-202 grounds existed to interfere with the private placement, the Commissions also noted that there was no reason to interfere with the Dolly Varden private placement under their public interest mandate.

Conclusion

The *Dolly Varden* decision confirms the continuing viability of private placements in contested M&A situations under the new take-over bid regime, and articulates a new framework for assessing their review by securities regulators that appears to include a healthy degree of deference to the business judgment of boards of directors. Given the significantly longer period of time that hostile bids must be open for under the new take-over bid regime (105 days as opposed to the 35-day regime that used to apply [even if rights plans typically resulted in the period being more in the 55 to 65 day range]), it is not unreasonable to assume that some issuers may well have legitimate financing needs to satisfy while a hostile bid is outstanding. The framework that the Commissions have set out will allow for careful consideration of the reasons for proceeding with a financing in a manner that is respectful of a board's business judgments in this regard. That said, given the basis on which the Commissions reached their decision in *Dolly Varden*, it remains to be seen how securities commissions will apply the factors enumerated in *Dolly Varden* in contexts where a private placement is more obviously in whole or in part a defensive tactic. Read literally, a private placement that is not undertaken as a defensive tactic will not be disturbed, regardless of its adverse impact on a bid, unless it raises public interest concerns. This raises the question as to whether there are any circumstances where a bona fide private placement would raise public interest concerns, and, if so, whether and how the public interest analysis would differ in practice or outcome from the defensive tactics analysis.