

Fair Play

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Mergers and acquisitions (M&A) activity is a core feature of the mining sector. Given recent market conditions, where capital inflows have been unevenly distributed between producing issuers and exploration companies, major companies are now facing the effects of historical cuts to exploration budgets with declining reserve and resource bases; this is a feature that many consider will continue in the mining industry.

There have been a number of legal developments over the past couple of years that all mining companies (and their boards of directors and management teams) should be aware of as they consider various strategic opportunities—both on the buy side and on the sell side. This article identifies some of the key issues and how mining companies are impacted.

Verifying a good deal

From the perspective of a target, M&A in the current environment is all about conducting a fair and reasonable process and ensuring that the process is seen to be fair. Boards of directors must demonstrate that a prospective transaction fairly values the company, which typically requires them to have completed a “market check” process. Directors owe a duty to act in the best interests of the company as a whole and to assess transactions from the standpoint of all stakeholders of the company, not just shareholders. That requires a more robust process than simply assessing offer price.

Public company M&A transactions requiring shareholder approval require the company to set out a detailed background of the transaction, describing the process that resulted in the transaction being put to shareholders. In recent years, market practice regarding disclosure has evolved to require more detail of the transaction timeline and insight into the deliberations of the board and, if applicable, a special committee of the board, including specific issues and alternatives considered, and the involvement of professional advisors.

For transactions involving companies incorporated in British Columbia, in the aftermath of the *InterOil* decision of the Yukon Court of Appeal (constituted by judges from the British Columbia Court of Appeal), courts are reviewing in greater detail the process followed and the disclosure of the process in the transaction management information circular, including relating to the receipt of fairness opinions (which is discussed in the next section of this article).

Similarly, the Ontario Securities Commission (the OSC) has recently announced its intent to subject transactions involving related parties that are subject to Multilateral Instrument 61-101 to greater regulatory scrutiny, which is also generally expected to require more comprehensive disclosure of the process followed.

Fair play

The market continues to deal with the aftermath of the *InterOil* decision, especially in British Columbia. In that decision, in assessing the fairness of a plan of arrangement transaction, the court questioned the utility of fairness opinions provided by financial advisors who are compensated with a success fee upon the completion of the transaction.

This is not the first time a regulatory body has made such observations; the OSC addressed similar concerns in a prior decision on a contested M&A transaction but later stepped back. Still, the market has been fixated on concerns over final order hearings for arrangement transactions. This is partly because final order hearings are one of the final steps of a transaction and come after shareholder approval has been obtained, when the court is required to assess the fairness and reasonableness of the arrangement transaction. No parties want to see a transaction fail at that stage, and typically the fairness hearing reviews the process followed by the board of directors of the target and the disclosure provided to shareholders for their approval, making it late in the process to correct any deficiencies.

In the aftermath of the *InterOil* decision, a market practice emerged of having a second fairness opinion provided by an independent financial advisor who is paid a fixed fee. Long form fairness opinions, that provide more analysis as to the methodologies applied and the analysis completed by the financial advisor, have also become more widespread.

These practices have been adopted even more-so in British Columbia-based transactions, but it is uncertain as to whether these changes will be permanent. Outside of British Columbia, there are numerous recent examples of issuers moving away from the *InterOil*-style disclosure. In the meantime, companies should carefully consult with their financial and legal advisors on the unique facts of each transaction to assess the optimal approach to addressing the challenges presented by the *InterOil* decision.

Concurrent financings in M&A transactions

There are many instances of target financings in the context of M&A transactions. The first is those circumstances in which a target has a need for financing prior to the completion of the transaction. The second is where a concurrent financing is done for deal certainty to provide a tactical advantage to the acquiror by giving the acquiror a toehold equity position that can be voted on at a shareholder meeting to consider the transaction.

Often, these two situations converge. It is important to consider the effect of a related party transaction and business combination rules in any financing and to ensure that the imposition of a concurrent financing does not inadvertently create more completion risk for the transaction. In addition, targets must be mindful of concerns of inadvertently (or intentionally) conducting a financing as a defensive measure to protect against the prospect of a hostile bidder or potential interloper.

Financings as a defensive tactic

The decision of the OSC and British Columbia Securities Commission (BCSC) in *Dolly Varden* should be welcome news for any exploration stage mining company. That case involved a private placement financing completed by Dolly Varden Silver Corporation in the face of a hostile take-over bid by Hecla Mining Company.

The OSC and BCSC (the Commissions) ruled that the private placement did not constitute an

unlawful defensive tactic to a take-over bid. The Commissions held that Dolly Varden was able to demonstrate a legitimate need for the financing and the private placement was not implemented as a defensive tactic in response to Hecla's bid.

Critics of this decision noted that as a mineral exploration company with no revenue, Dolly Varden was always dependent on the market to finance its exploration activities and that other factors, such as Dolly Varden's decision to significantly increase the size of the placement in the face of the bid, should have carried more weight with the Commissions to set aside the financing.

However, the takeaway for capital-intensive mining companies that are sensitive about being a take-over target is to prioritize financing considerations as a corporate objective to maximize the chances of a financing in the face of a take-over bid being upheld. It is advisable that the board carefully reviews financing needs and opportunities and appropriately reflect its considerations in the meeting minutes to maintain a paper trail that supports a narrative over an extended period of time.

Future of shareholder rights plans

With the overhaul of the Canadian take-over bid rules in May 2016, there was speculation as to whether we had seen the last shareholder rights plan hearing in Canada. The new take-over bid rules require a hostile bid to remain open for 105 days, as opposed to 35 days under the former rules (while most shareholder rights plans permitted a take-over bid with a 60-day tender period) and restricted partial bids, so many of the primary purposes for shareholder rights plans became embedded in Canadian securities laws.

However, the recent decision of Canadian securities regulators in the *Aurora/CanniMed Therapeutics* transaction suggests that there may still be a role for shareholder rights plans in protecting target companies. In particular, "poison pills" that regulate joint actors and lock-up agreements that enable prospective acquirers to "creep" (i.e., assemble share blocks as a tactic to strengthen their position and likelihood of success) may still be worthwhile protections, particularly where such plans are implemented and approved by shareholders on a periodic basis (as opposed to a "tactical plan" adopted by a board in the face of unfriendly activity).

Indeed, after a period of limited adoption of shareholder rights plans following the adoption of the new take-over bid regime, the *CanniMed* decision has resulted in an uptick in companies implementing shareholder rights plans.

Conclusion

In a volatile market, it is advisable for all mining companies to constantly monitor strategic opportunities and market conditions. M&A transactions can be very intensive situations for both targets and acquirors, and involving knowledgeable advisors as early as possible can aid in significantly mitigating transaction risk.

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