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Poison pills under the new bid regime: lessons & questions flowing from Canada's largest cannabis M&A deal to date

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On December 22, 2017, the Ontario Securities Commission (OSC) and the Financial and Consumer Affairs Authority of Saskatchewan (FCAAS and, together with the OSC, the Commissions) issued an order after a joint hearing that immediately cease traded a tactical shareholder rights plan that CanniMed Therapeutics Inc. (CanniMed) had adopted in response to an unsolicited take-over bid by Aurora Cannabis Inc. (Aurora). Prior to the formal launch of the Aurora bid, CanniMed announced that it had reached a friendly acquisition agreement under which it would acquire all of the outstanding shares of Newstrike Resources Ltd. (Newstrike). One month after the order was issued, the Newstrike acquisition was terminated and Aurora and CanniMed reached an agreement enabling Aurora to acquire CanniMed in a transaction valued at approximately $1.1 billion, making it the largest transaction to date in Canada's cannabis sector.

On March 15, 2018, the Commissions issued their reasons explaining the basis for their December order. The Commissions' reasons are noteworthy because they mark the first "poison pill" decision by Canadian securities regulators since the new take-over bid regime (the New TOB Regime) was adopted across Canada in May 2016 (NI 62-104). The New TOB Regime was enacted after considerable debate that saw Canada's securities regulators unable to find common ground with respect to proposed reforms to the regulation of defensive tactics, including shareholder rights plans. The absence of consensus left open the question how regulators called upon to hear challenges to shareholder rights plans would deal with them in light of the New TOB Regime.

We previously reviewed the timeline of events and principal issues that the decision addressed.[1] In this Update we focus on the Commissions' analysis, with a particular emphasis on those parts of their reasons that will be of importance to subsequent M&A transactions.

- **Tactical rights plan that frustrates use of lock-ups or the 5% exemption risks being rapidly cease traded:** In what is undoubtedly the most significant part of their decision, the Commissions found that the tactical shareholder rights plan that CanniMed's board of directors (the Board) adopted in response to Aurora's hostile bid was problematic and should therefore be immediately cease traded. The Commissions noted early on in their decision that it was inappropriate in this context to invoke their public interest authority to prohibit Aurora from availing itself of the exemption to acquire up to 5% of CanniMed's shares in ordinary market transactions while the Aurora bid was outstanding (the 5%

Exemption), while recognizing that there might be other cases where prohibiting the use of the 5% Exemption would be in the public interest (e.g., in cases where its use would undermine the policies underlying the New TOB Regime). Turning to the CanniMed rights plan, the Commissions were troubled that in circumstances where the Commissions had determined that there was no public interest basis for prohibiting Aurora's use of the 5% Exemption, the rights plan deemed locked-up shares to be beneficially owned by Aurora, with the result that Aurora could not use the 5% Exemption to acquire CanniMed common shares without triggering the rights plan. The Commissions placed a great deal of weight on their conclusion that the rights plan was principally designed to protect the Newstrike transaction and to resist the Aurora bid and was not being used to seek higher bids. Importantly, the Commissions suggested that as a result of the amendments giving rise to the New TOB Regime, prior decisions of the OSC regarding rights plans were of limited use in this case. They went on to state that lock-up agreements are not only a "lawful and established feature of planning for M&A transactions in Canada," but they are even more important in a bidder's planning after the New TOB Regime because the risks to completion for a bidder have been increased by virtue of the longer period of time that a bid must stay open and the bidder's inability to waive the minimum tender condition. The Commissions were therefore of the view that it "will be a rare case in which a tactical plan will be permitted to interfere with established features of the take-over bid regime such as the opportunity for bidders and shareholders to make decisions in their own interests regarding whether to tender to a bid by entering into lock-up agreements of the kind under consideration in this case." Moreover, the Commissions stated that tactical rights plans "should not generally be utilized to deem a bidder to beneficially own locked-up shares in circumstances where they would not be deemed to be joint actors under the applicable rules." Issuers and their advisors will need to take note of the forcefulness with which the Commissions objected to the use of a tactical rights plan to restrict a hostile bidder's ability to enter into lock-ups of any kind or to avail itself of the 5% Exemption. Indeed, the Commissions' comments in this regard go beyond what was needed to address the facts of this case and raise important questions. This is all the more true given that the Canadian Securities Administrators (CSA) avoided any discussion of its views on the implications of the New TOB Regime for defensive tactics when they adopted that regime. Rights plans have for some two decades drawn a distinction between "soft" lock-ups and "hard" lock-ups (i.e., between lock-ups that allow the locked-up shareholders to tender to a superior offer and those that do not), typically permitting soft lock-ups but restricting the use of hard lock-ups. This balance was the result of negotiations over many years between issuers and Fairvest (now part of ISS) and represented a well-accepted compromise between issuers and institutional investors that was designed to give boards room to attract competing bids, while at the same time allowing for a range of lock-up arrangements that would encourage bidders to make offers. It is not clear whether the Commissions concluded that this middle ground is no longer acceptable, especially in circumstances when a target faced with a hostile bid decides to seek other competing bids. Nor is it clear whether the fact that targets now have more time to react to a bid than they

did prior to the New TOB Regime fundamentally alters the rationale underlying the previously accepted compromise. In this regard, we note that the decision does not address the fact that CanniMed's tactical rights plan was unusual in that it drew no distinction between hard lock-ups and soft lock-ups. Indeed, unlike many tactical rights plans (and all ISS compliant shareholder approved rights plans) which do allow for soft lock-ups, the CanniMed rights plan deemed shares subject to any lock-up to be beneficially owned by the bidder. Tactical rights plans and shareholder approved rights plans have long had the effect of constraining access to the 5% Exemption when it would otherwise enable a bidder to acquire more than 20% of the target's shares other than through a permitted bid. At the same time, rights plans have not prevented access to the 5% Exemption when it would not result in a bidder coming to control more than 20% of the target's shares, whether directly or through the use of lock-up agreements. This is consistent with the restriction that rights plans have long placed on take-over bid exemptions that might be used to creep over the 20% threshold prior to launching a bid, such as the private agreement exemption. There will certainly be circumstances where use of the 5% Exemption by a bidder controlling a very sizeable block of shares, either through its direct ownership or through the use of hard lock-ups, could make it virtually impossible for another bidder to succeed with an offer and would therefore foreclose any attempt on the part of the target to run a meaningful auction. It will be interesting to see whether securities regulators faced with a fact situation of this kind will be more amenable to the use of a rights plan to constrain the use of the 5% Exemption, or will be more receptive to public interest arguments for prohibiting the use of the 5% Exemption by a bidder. Of particular interest in this regard will be the position that the Autorité des marchés financiers (the AMF, which is Québec's securities regulator) takes, given that the AMF made clear in a consultation paper released in 2013 that it was far more open to the use of defensive tactics than other members of the CSA. The facts of this case involved the adoption of a tactical rights plan in response to a hostile bid supported by over a third of the issued and outstanding shares of the target. However, even after the adoption of the New TOB Regime, many issuers have continued to adopt shareholder approved rights plans when they are not subject to a bid, and these rights plans have very often received high levels of shareholder support when presented for ratification (i.e., within six months of adoption, pursuant to applicable TSX requirements). Prior to the Aurora decision, shareholder approved rights plans were rarely effectively challenged at the beginning of a bid. Instead, they were typically cease traded when the bid had been outstanding for between 50 to 70 days. This meant that they served to restrict hard lock-up agreements and access to the 5% Exemption for 50 to 70 days. Issuers and their advisors will now need to consider whether the Aurora decision means that shareholder approved rights plans will be more vulnerable to attempts early in the pendency of a bid to have them cease traded in circumstances where the bidder can demonstrate that the rights plan is restricting the bidder's ability to enter into lock-ups or to have access to the 5% Exemption. Careful thought will have to be given to the weight that securities commissions can be expected to give to the fact that shareholders have approved these restrictions and that

they are known to a bidder before it launches a take-over bid (as opposed to a tactical rights plan adopted without shareholder approval and in response to a bid). The CSA's inability between 2013 to 2016 to reach consensus on an appropriate approach to the regulation of defensive tactics was bound to leave open many questions once the New TOB Regime came in to force. The forcefulness with which the Commissions in the Aurora decision criticize the use of a tactical pill, and the many questions that the decision gives rise to, suggest that it is highly desirable that the CSA not abandon efforts to forge a unified position with respect to the role that defensive tactics should play in light of the New TOB Regime.

- **Lock-up agreements do not necessarily mean parties are acting jointly or in concert**: The Commissions found that, based on the evidentiary record before them, they could not conclude that shareholders who had signed lock-up agreements with Aurora with respect to 35.66% of CanniMed's outstanding common shares were acting jointly or in concert with Aurora. The Commissions noted that the fact that these agreements were hard lock-ups as opposed to soft lock-ups was not, in and of itself, enough to give rise to a conclusion that the locked-up shareholders were acting jointly or in concert with the bidder. Indeed, the Commissions characterized lock-up agreements as "an established practice in M&A transactions." They then noted that the fact that the agreements provided that the locked-up shareholders had agreed to vote against the Newstrike transaction and to tender to the Aurora transaction did not in and of itself mean that these shareholders were acting jointly or in concert with Aurora. The Commissions stressed that "the presumption that an agreement to exercise voting rights leads to joint actor status can be rebutted, where, as here, the voting rights are tailored to be consistent with and to support otherwise permissible commitments to tender securities to a bid." The Commissions' reasons provide a useful overview of factors that those structuring lock-up agreements will wish to consider when assessing whether they can be entered into without parties being deemed joint actors under applicable securities laws. The reasons make clear that sensitivity must be shown to the nature of constraints imposed on voting rights and that failure to tailor these constraints appropriately could result in the parties being characterized as joint actors.
- **Access to material non-public information does not necessarily mean parties are acting jointly or in concert, but does raise disclosure issues**: At the joint hearing, the Special Committee of CanniMed argued that the timing of certain communications between one of CanniMed`s significant locked-up shareholders and the Board permitted an inference that the locked-up shareholders had provided Aurora with material non-public information (MNPI) concerning the nature and timing of CanniMed's intention to acquire Newstrike. The Commissions agreed, concluding that the communication from the locked-up shareholder "strongly suggested" that it knew that action by the Board to move forward with the Newstrike transaction was imminent. However, the Commissions did not feel that was enough, based on the evidentiary record before them, to conclude that the locked-up shareholders actively participated in the planning of Aurora's bid such that they could be viewed as joint actors. [2] That said, the Commissions were of the view that receipt

of MNPI gave rise to important disclosure issues. In particular, the Commissions stated that CanniMed shareholders were entitled to know about Aurora's receipt of MNPI, as this might have some bearing on their decision whether to tender their shares to Aurora's bid. For example, and as the Commissions noted, shareholders can reasonably be expected to consider the facts related to the transmission of MNPI as a potential "ethical consideration" in deciding whether to tender to a bid. The Commissions therefore ordered that Aurora amend news releases concerning its bid, as well as its take-over bid circular, in order to provide details concerning how Aurora became aware, before launching its bid, that the Board would be meeting to consider the Newstrike transaction. The Commissions' reasons underscore the need for shareholders with access to MNPI who are seeking to put a company in play to consider the implications of sharing MNPI with a potential bidder. Similarly, parties approached by shareholders who wish to share MNPI will need to balance the desire to have access to this information with careful consideration of the disclosure implications of receiving that MNPI, as well as of how target company shareholders may react to this disclosure.

- **CanniMed-Newstrike transaction not a defensive tactic or alternative transaction:** The Commissions found that CanniMed's agreement to acquire Newstrike had been the subject of detailed discussions between these parties long before Aurora made its bid for CanniMed. The Newstrike transaction could therefore neither be seen as a defensive tactic deployed in response to the Aurora bid, nor as a transaction subsequently developed as an alternative to the Aurora transaction. As a result, the Commissions saw no case for accepting Aurora's submission that the Newstrike transaction should be treated as analogous to the type of alternative transaction that would allow for a reduction under NI 62-104 of the minimum deposit period to which the Aurora bid was subject from 105 days to 35 days. Although succinct, the Commissions' analysis of the reasons why the Newstrike transaction was not a defensive tactic will prove a useful reference point in understanding the factors that Canadian securities regulators will look to when assessing whether a transaction was entered into in order to frustrate a bidder's efforts to acquire the target. In this instance, the fact that the record showed that there was a developed strategic rationale for the transaction and that negotiations had been underway well before Aurora made its bid were especially important considerations.

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[1] Securities regulators referee the Aurora hostile bid for CanniMed

[2] The Commissions specifically noted that not having the locked-up shareholders participate at the hearing (either through intervenor status or as witnesses) necessarily limited the evidentiary record regarding the interactions between Aurora and these shareholders.