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The Eco Oro decision – OSC invokes broad jurisdiction in effectively neutralizing a private placement

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Authors: Jeremy Fraiberg, Emmanuel Pressman, Lawrence E. Ritchie, Alex Gorka, Donald Gilchrist

In this Update

- OSC has invoked broad jurisdiction through its remedies in overturning the TSX's approval of a private placement in the context of a proxy contest.
- Whether or not a private placement "materially affects control" requires contextual analysis and not mere adherence to whether a 20% shareholder resulted from the transaction.
- Ongoing litigation before courts and securities regulators highlight potential for forum shopping.

The Ontario Securities Commission (OSC) recently released its reasons [PDF] for overturning a decision by the Toronto Stock Exchange (TSX) conditionally approving a private placement of shares (the Share Issuance) in the context of a proxy contest. As described in an earlier Osler Update, the TSX had approved the issuance of almost 10% of the common shares of Eco Oro Minerals Corp. (Eco Oro) to certain existing shareholders (the Supportive Shareholders) supportive of the incumbent board of directors just eight days prior to the record date for a shareholders' meeting requisitioned to replace the directors.

In its decision, the OSC highlighted that at the time of approving the Share Issuance, the TSX was unaware of, or did not absorb, the fact that Eco Oro was subject to a proxy contest and an impending shareholders' meeting requisitioned by dissident shareholders. The OSC also indicated that these facts were not disclosed in writing to the TSX pursuant to the application for approval in Eco Oro's Form 11 – Notice of Private Placement (Form 11) and that Eco Oro's application was treated as routine because the TSX was unaware of the proxy contest.

Several important interpretations and issues have emerged from the OSC's reasons, including the following:

1. Meaning of "materially affect control"

The TSX's decision to allow the Share Issuance, and the OSC's decision to overturn the TSX's decision, turned in large measure on whether or not the Share Issuance "materially affected control" of Eco Oro. Shareholder approval is required, pursuant to the TSX Company Manual, if a share issuance will "materially affect control" of an issuer. The Share Issuance would

result in the Supportive Shareholders increasing their aggregate voting control of Eco Oro from approximately 41% to 46% and the OSC found that the Share Issuance "could reasonably tip the balance in favour of management."

Relying on the Form 11 submitted by Eco Oro, the TSX determined that the Share Issuance would not materially affect control of Eco Oro and therefore did not require shareholder approval. In overturning the TSX's decision, the OSC determined that the TSX was not entitled to deference given that the TSX did not fully consider the ongoing proxy contest in making this determination. Moreover, the OSC rejected the argument that the Share Issuance did not materially affect control, even in the context of a proxy battle, on a theory of "enduring control" (i.e., that consideration of the effect of a share issuance on a transient vote at an upcoming meeting is inappropriate and that the TSX should focus on whether a new 20% shareholder was created or whether a voting trust among shareholders holding 20% was put into effect). The OSC instead stated that "the public interest requires an evaluation of whether an issuance of shares by a listed issuer is for the purpose of entrenching management in the face of a proxy contest."

Going forward, greater scrutiny is likely to be placed on the Form 11 that issuers submit to the TSX when seeking approval of a private placement in the context of an ongoing proxy contest and other contested situations. The OSC noted that it is important for any material facts to be included in the written materials exchanged between issuers and the TSX, as opposed to only being the subject of discussion, and that in the context of a close vote on a board election "the TSX should generally exercise its discretion to require a vote to promote the fair treatment of shareholders and the quality and integrity of Ontario capital markets." Going forward, the net effect is that TSX approval may take more time to obtain and may more often be conditioned upon there being a gap between announcement and closing.

2. Broad interpretation of OSC jurisdiction

A significant portion of the decision is focused on the OSC's jurisdiction. Prior to this decision, a remedy to unwind a transaction or disenfranchise the voting rights of a shareholder was typically sought before a court, not a securities commission. In its decision, the OSC relied on the authority to make "such other decision as the [OSC] considers proper" in the context of a review of a TSX decision. Eco Oro has appealed the OSC's decision to the Ontario Divisional Court.

While the OSC rendered its decision pursuant to a provision of Ontario securities law that provides for the review of TSX decisions, the OSC also indicated that, whether or not there is a TSX decision, a person may seek to invoke the OSC's public interest jurisdiction under Ontario securities laws based on the underlying policies in *National Policy 62-202 – Take-Over Bids – Defensive Tactics* (NP 62-202). The reference to NP 62-202 is instructive as there is now a line of decisions addressing the use of private placements in the context of contested take-over bids, most recently the *Dolly Varden* decision described in our Osler Update published on October 28, 2016.

In the Eco Oro decision, the OSC noted that although NP 62-202 addresses take-over bids, "the public interest in promoting fairness to shareholders clearly extends to ensuring fair contests for control whether pursued through the proxy solicitation process for contested shareholder meetings or by way of a take-over bid."

Given the increased prevalence of proxy contests in the Canadian marketplace in recent years, the OSC's acknowledgement that this alternative method of acquiring corporate control raises similar policy issues to a take-over bid is a significant development.

3. OSC's willingness to "unscramble the egg"

With TSX approval, Eco Oro issued shares without obtaining approval from its shareholders. The OSC had to determine what remedy, if any, was appropriate given that the Share Issuance had been completed, noting that "reversing transactions, even at the direction of shareholders, cannot be undertaken lightly."

The OSC specified the following factors as relevant in determining whether it is in the public interest to order that a completed transaction be reversed:

- whether the issuer afforded those that it knew were likely to object to the share issuance an opportunity to raise their objections to the decision-maker in advance of the transaction closing, including by means of a press release sufficiently in advance of closing
- whether those directly affected by the reversal of the transaction entered into the transaction knowing of the likelihood of objections
- whether those directly affected by the reversal of the transaction had an opportunity to be heard and/or make submissions
- whether it is impractical for the transaction to be reversed in the circumstances

In the circumstances, the OSC found that the factors were satisfied. The OSC noted that "a potential reversal of a transaction in this case would not involve a return of proceeds to the subscribers who provided capital through such issuance for a compelling corporate purpose since no new proceeds were obtained. In this case [...] to reverse the [Share Issuance] and restore the original amount of the Notes, the practical effect on Eco Oro and the [Supportive Shareholders] is minimal." The OSC ordered that Eco Oro ask shareholders to either ratify the Share Issuance or instruct the board of Eco Oro to reverse it. The OSC also ordered the board of directors of Eco Oro take all necessary steps to reverse the Share Issuance should shareholders instruct the board of directors to do so. Finally, pending shareholder ratification of the Share Issuance, the OSC cease traded the shares issued pursuant to the Share Issuance and ordered Eco Oro and the chair of any Eco Oro meeting not to consider such shares to be issued for the purposes of voting at any shareholders' meeting.

While novel, the OSC's remedy in this case builds on previous decisions where securities regulators effectively unwound a transaction or caused parties to act in a manner so as to preserve the possibility of unwinding a transaction.

4. Conflict with B.C. courts?

In addition to the proceedings before the OSC, Eco Oro and the dissident shareholders have litigated this matter before the British Columbia courts. This has resulted in decisions that on their face may appear to be conflicting, but can be reconciled on the basis that the British Columbia courts have addressed corporate law issues, such as oppression, while the OSC has focused on whether the TSX should have required a shareholder vote to approve the Share Issuance.

The Supreme Court of British Columbia (the B.C. Court) dismissed a petition by Eco Oro shareholders to set aside the issuance of Eco Oro's shares on the basis of oppression. In supplementary reasons issued in light of the OSC's decision, the B.C. Court indicated that "the OSC's decision and my decision are at odds" and adjourned the Eco Oro shareholders'

meeting "to allow the parties an opportunity to take whatever steps they deem appropriate to resolve the conflict between the OSC's decision and my decision."

The B.C. Court of Appeal subsequently set aside the decision of the B.C. Court adjourning the shareholders' meeting, noting that "the chambers judge erred in principle in his characterization of the OSC's order as 'in conflict' with his own and that this error affected the exercise of his discretion in adjourning the shareholders' meeting." The OSC insisted that its decision "is not based on corporate law considerations. Our role is to ensure that listing standards, which are required to be approved by the [OSC] as consistent with the public interest, are properly administered."

Yet the OSC and the B.C. Court considered overlapping facts and reached differing conclusions as to Eco Oro's conduct. The OSC stated that the Share Issuance "was clearly designed to have a material effect on the Meeting," that any balance sheet improvement resulting from the partial conversion had little practical positive effect for Eco Oro, that the motivation for the Share Issuance was "at best a mixed one" and that "the evidence of the tactical motivation underlying the timing of the [Share Issuance] and the accelerated closing is overwhelming." The B.C. Court, on the other hand, found that "there is nothing in the evidence to challenge the Board's bona fides in making the [Share Issuance] at the time it did. I see nothing improper in the timing."

These decisions highlight the fact that contested corporate actions can result in overlapping review by both courts and regulators, with potentially differing results. This can lead to forum shopping, multiplicity of litigation, and result in regulatory and legal uncertainty for market participants.

In an article for the Financial Post, author Drew Hasselback uses this Osler Update as a reference while discussing the implications of the Eco Oro decision. Read the full article "Eco Oro case shows regulators are willing to 'unscramble the egg'" here.