



Université d'Ottawa | University of Ottawa

Faculty of Law | Common Law Section

57 Louis Pasteur Ottawa ON K1N 6N5 Ph: 613-562-5800 Fax: 613-562-5124

July 11, 2013

The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 2S8

Re Proposed National Instrument 62-105, Request for Comments

I have great pleasure in submitting herewith my comments on the captioned instrument. I would appreciate if you can take them on record and include among the submissions received, to enable their consideration. I would also like to know if there is a plan to conduct personal hearings in the matter.

I would be grateful for your acknowledgment of receipt and confirmation that my submission is in order. Please do let me know if you have any questions or concerns.

Thanks & Regards,

A handwritten signature in black ink, appearing to read "P.M. Vasudev".

P.M. Vasudev LL.M. Ph.D.
Assistant Professor

Encl. 1. General Comments
 2. Responses to Queries

Proposed National Instrument 62-105, *Security Holder Rights Plans*
And
Proposed Companion Policy 62-105CP, *Security Holder Rights Plans*

General Comments

1. Introduction

Formal regulation of Security Holder Rights Plans (“Rights Plans”), which are instruments developed in the market in the 1980s, can be a positive measure. Widespread adoption and use of such Plans by reporting issuers possibly makes regulation more appropriate. The current proposal of Canadian Securities Administrators (CSA) for regulation of Rights Plans is in keeping with the trend of development of corporate and securities law. Here, innovations in the marketplace are usually followed by measures to regulate and streamline practice and clarify principle.

As the proposal published by CSA points out, Rights Plans are already subject to procedural safeguards under the rules of the Toronto Stock Exchange (TSX).¹ The TSX rules provide for transparency of Plans and require shareholder approval for them. In addition to this intervention by TSX, securities regulators consider challenges to individual Rights Plans when raised.

The present proposal of CSA adopts the TSX principle of shareholder approval for Rights Plans and seeks to streamline the framework. It travels further with respect to grant of exemptions by company boards from the operation of Rights Plans. The proposal is to make exemptions mandatory for all bids, if the board of a target corporation exempts any particular bid from the Rights Plan.

These submissions comments cover issues of principle as well as logistics or technicalities, mainly due to implications under the Ontario *Securities Act (OSA)*² and the *Canada Business Corporations Act*.³ General comments are in Part 2. CSA has posed several specific queries in the Request for Comments, and responses to these queries are in a separate document.

There could be an issue about how far some of the recommendations made here – for example, the fiduciary standards to govern the preparation of Rights Plans – are appropriate for inclusion in a National Instrument to be framed by CSA. It could be argued that CSA’s limited concern is with the securities markets of Canada and it lacks jurisdiction to address larger issues of corporate governance. However, it is submitted that this would not be an appropriate approach.

It is increasingly recognized that the good governance of business corporations is essential to their long-term wellbeing, which can ensure their contribution to the national economy and welfare. Therefore, securities regulation is intertwined with corporate governance and it would be better to avoid highly stylized approaches that can dilute regulatory efficacy.

¹ TSX Listed Company Manual, sections 634-637.

² RSO 1990, c. S-5.

³ RSC 1985, c. C-45.

2. Comments

The CSA proposal departs from the largely passive role that is assigned to the directors of target corporations in the takeover regime in the Ontario *Securities Act*. Instead, the proposal implicitly recognizes that incumbent managements can resist takeover bids. As already pointed out, current regulatory efforts reflect the fact that Rights Plans are already a common feature in Canadian landscape. In this sense, CSA proposal promotes regulatory alignment with market practice.

There is no regulatory plan to intrude into the contents of Rights Plans. This is left to individual boards which are only placed under a duty to obtain shareholder approval for the Plans. Boards can determine the type of safeguard they wish to have in place and the circumstances in which it would be triggered. In essence, proposed regulation seeks to balance the goal of promoting shareholder choice and value with enabling incumbent managements to resist bids and protect themselves if they have shareholder approval to do so.

This part contains general comments on the regulatory proposals, which fall into two categories – substantive and logistical. The substantive comments deal with (a) shareholder approval of Rights Plans, (b) the fiduciary standard applicable to target company directors, and (c) the rule that waivers of Rights Plans must be applied uniformly to all bids. The logistical comments, which follow, raise the issue of potential implications under *OSA* and the *CBCA*, in the implementation of Rights Plans regulation.

A. Substantive

a. Shareholder Approval as the Measure of Rights Plans

The practice of seeking shareholder approval for Rights Plans, followed in the UK, is more aligned with the principle of shareholder primacy and with UK law on the subject. While the requirement of shareholder approval, which has been adopted by TSX, can check directors' power, a question in the Canadian context is whether the rule takes sufficient account of emerging notions on the fiduciary duties of directors and judicial interpretation of the "best interests of corporations."⁴ In recent cases – namely, *People's Department Store v Wise* (2004)⁵ and *BCE Inc v 1976 Debentureholders* (2008),⁶ the Supreme Court of Canada adopted a more expansive version of corporate interests and included non-shareholder groups, such as employees and suppliers, in the definition.

In substance, the rule on shareholder approval of Rights Plans treats takeover bids and change of control as simply a bilateral issue between shareholders and directors of target corporations. The question is whether this is appropriate in the evolving scenario. In considering this issue, it is necessary to refer to the history of development of Rights Plans, or so-called poison pills, in the United States. This happened in the 1980s, during the takeover battles of that decade. A major argument in favor of poison pills was

⁴ These comments are closely related to the next set of comments on fiduciary standards applicable to corporate directors and managers. The CSA proposal is sensitive to the tension in this area and makes a reference to the issue in Part 4(b)(iii) of the "Background" section.

⁵ [2004] 3 SCR 461, 2004 SCC 68.

⁶ [2008] 3 SCR 560, 2008 SCC 69.

that shareholders were not the only constituency that had an interest in the change of control of a corporation. Moreover, shareholders could often be driven by short-term considerations.⁷ This origin explains the absence of shareholder approval for Rights Plans in the US. Rather, the Plans are treated as being derived from the general powers of the directors who would be bound by their fiduciary duties in this regard. This can promote integrity of the Plans and director accountability.

It is, therefore, necessary to consider whether shareholder approval, by itself, is adequate for a Rights Plan. At the same time, it is legitimate to provide internal controls on director power in devising Rights Plans. Shareholder approval would be an efficient mechanism in this regard, but there is equally a need for sensitivity to the problems that have been identified or experienced. A workable alternative could be to retain shareholder approval, and also provide regulatory guidance to the directors in the preparation of Rights Plans. The guidance can include the considerations to be applied in developing the Plans and in devising defensive mechanisms. This issue is also connected with the fiduciary standards governing corporate managements which are addressed next.

b. Fiduciary Standard for Target Co Directors/Managers

As already pointed out, the CSA proposal is sensitive to the emerging expansive version of the fiduciary duties of directors and its implications for Rights Plans. In dealing with takeover bids, directors of target corporations are under the general fiduciary standards applicable to them.⁸ Specifically in the context of takeovers, the duty of directors under the Ontario *Securities Act* to provide a circular to shareholders is equally governed by the fiduciary standard.⁹ More specifically in the context of Rights Plans also, courts have tended to rule against plans that are too restrictive and heavily favor incumbent managements.¹⁰

A major tension in this area is about the scope and extent of the fiduciary duties of directors of target corporations in takeover bids. This can give rise to the enduring shareholder-stakeholder debate in corporate and securities law. In dealing with hostile takeover bids, a management might justify defensive action under a Rights Plan by relying on the broad conception of fiduciary duties and argue that its actions are in the best interests of the corporation understood in this larger sense. As I have already stated, this was among the rationales for poison pills as they developed in the United States. Yet, quite often, a broad conception of corporate interests can come in the way of shareholders realizing best value for their shares.

Delaware court has adopted a flexible, facts-specific approach that can go in either direction, depending on the circumstances of a case. In *Revlon v MacAndrews & Forbes Holdings*,¹¹ the directors of the target corporation facing breakup were held to a duty to maximize shareholder value. But a year earlier in *Unocal v Mesa Petroleum Co*,¹² the court upheld the defensive action of the directors of the target corporation accepting a broader interpretation of the corporation and the various groups, including

⁷ See e.g. Martin Lipton, "Takeover Bids in the Target's Summer" (1979) 35 Bus. Lawyer 101.

⁸ See e.g. *CBCA*, section 122(1).

⁹ Ontario *Securities Act*, section 95.

¹⁰ See e.g. *347883 Alberta Ltd v Producers Pipelines Inc*, [1991] 4 WWR 577 (Sask. CA).

¹¹ 506 A.2d 173 (Del. 1986).

¹² 493 A.2d 496 (Del. 1985).

non-shareholders, it comprised. The presence of these two divergent standards of fiduciary duties – the *Revlon* standard and the *Unocal* standard – makes the situation rather amorphous. It can give rise to conflicting claims, especially in Canada with the recent exposition of the “best interests of corporations” by the Supreme Court of Canada in *People’s Department Store* and *BCE Inc* referred to earlier.

Regulatory guidance on the considerations to govern Rights Plans, suggested earlier, can be helpful in the area of fiduciary standards as well. For instance, it would be useful to clarify that in relying on a Rights Plan, directors must explain the impact they expect a takeover bid to make on the corporation and the interests of the several groups in it, including shareholders, and whether implementing the Rights Plan serves any purpose other than simply defeating the bid and protecting the management. This mechanism can promote transparency and also corporate accountability, by promoting management’s fidelity to the statements they make during the efforts to resist or oppose takeover bids. It would be the counterpart of Item 16 of Form 62-504F1 (Takeover Bid Circular) which requires bidders to disclose the purpose of the bid and any material changes or proposals with respect to the target corporation.

c. Rule for Mandatory Waiver of All Bids from Rights Plan (section 4)

This comment is related to the previous one on fiduciary duties. Under the CSA proposal, if the directors of a target corporation waive the Rights Plan in dealing with any bid, they must do so for all other bids. This rule promotes uniformity and can potentially discourage incumbent managements from showing favours to select bidders. But it can have other implications that could impede optimal performance of the takeover regulation regime.

By granting regulatory recognition to Rights Plans, the CSA proposal upholds that managements can take affirmative action to resist takeover bids. In essence, Rights Plans would grant directors of target corporations an option to oppose bids, and not place them under a duty to do so. A necessary part of this exercise is directors’ determination about opposing a bid or supporting it and the discretion available to them make the choice.

Any other interpretation, in particular one that compels directors either to oppose or be passive against all bids would have serious consequences. For one, it would likely defeat the regulatory goal of encouraging takeover bids as a discipline on managements and promoting efficient allocation of resources. Secondly, leaving directors without a choice would likely run counter to the fiduciary standard governing them, more specifically their statutory duty to provide a circular under the *OSA*, section 95.

It is, therefore, important that directors have the freedom to exercise discretion and determine whether a bid is in the best interests of the corporation. This would be consistent with the fiduciary duties of the directors and reflect the position that in dealing with takeover bids directors must choose between bids that are good and ones that are not so. This principle is implicit in *OSA*, section 95.

The measures suggested earlier – namely, regulatory guidance on considerations in developing Rights Plans and requiring directors to explain their reasons for implementing a Rights Plan in a given case can provide sufficient safeguard against arbitrary decision-making by the directors.

B. Logistical Comments – Harmonizing with Ontario *Securities Act*, Part XX

At present, most of the regulation of takeover bids is under the Ontario *Securities Act (OSA)*, Part XX. As already pointed out, Rights Plans that are designed to foil takeover bids might be incongruent in the *schema* of regulation under the *OSA*. Similarly tying the hands of the directors of a target corporation from implementing Rights Plan in dealing with a particular bid, because they waived the Plan for some other bid might be opposed to their fiduciary duties. The Proposed Rule would be a National Instrument framed by provincial securities regulators. To the extent that these regulations are perceived to be discord with the provisions of a statute dealing with the subject, the risk of legal challenge is obvious. Pending legislative amendments to the *OSA*, it is necessary to examine the implications of any conflict between the Proposed Rule and the statute.

The queries posed in the Request for Comments (#14) refer to dissident shareholders and the need for any special safeguards for them. This *is* a concern but traditionally it has been addressed in corporate law. A question that arises is how far securities regulators can venture into this territory when dealing with the more limited issue of Security Holder Rights Plans. Therefore, the interests of dissenting shareholders, although a legitimate concern, might not be permissible or appropriate for inclusion in the Proposed Rule, if only due to technical reasons and the structure of law. In the accompanying Responses to Queries, a recommendation is made for including opposition to Rights Plans among the grounds for exit of dissenting shareholders under section 190 of the *Canada Business Corporations Act*.

The issues discussed above are areas for legislative action by Provincial Legislatures/ Federal Parliament. While framing the Proposed Rule, CSA may consider making recommendations for effecting necessary legislative amendments or enacting new provisions in provincial/federal statutes, as applicable.

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Responses to Queries Posed in Request for Comments

General

1. In your view, is the Proposed Rule preferable to the status quo, amending the bid regime to mandate “permitted bid” conditions and disallow Rights Plans, or amending NP 62-202 to provide specific guidance on when securities regulatory authorities would intervene on public interest grounds to cease trade a Rights Plan?

Response:

- The proposed rule is preferable to *status quo* because it acknowledges the reality of Security Holder Rights Plans which are all over the market. It is better to recognize and try to manage them, rather than be passive or reactive.
 - The second alternative of laying down mandatory “permitted bid” conditions and/or disallowing Rights Plans would drastically interfere with market practices. Quite apart from philosophical views on the subject, the practical usefulness of the approach is also open to question. It is unlikely that market participants will docilely accept these eventualities; rather, it is reasonable to expect actors in the market to develop creative solutions. In other words, this rather extreme approach is unlikely to yield meaningful results.
 - The third option of providing guidance on intervention in Rights Plans by securities regulators, possibly along the lines suggested in *Re Royal Host Real Estate Investment Trust Board* (1999)¹ is not very different from *status quo*. It may not take us further in dealing with Rights Plans. An alternative, suggested in the accompanying General Comments, is to provide guidance do directors on the considerations that must govern the development of Security Holder Rights Plans with sensitivity to the fiduciary standards. This can streamline Rights Plans and avoid debates/litigation on fiduciary duties of directors. As a result, the need for regulatory intervention in individual cases can be significantly reduced.
2. Do you think that implementing the Proposed Rule will reduce the need for securities regulators to review Rights Plans through public interest hearings? Please provide details.

Response:

It is debatable whether the Proposed Rule, in its current form, can reduce the need for review of Rights Plans by regulators. This is because the Proposed Rule does not introduce any radical changes with respect to the development of Rights Plans or their content. If it is a goal to reduce the need for regulatory review of Rights Plans, the inclusion of guidance on governing standards, recommended in the accompanying General Comments, can be helpful.

¹ 22 OSCB 7819, para. 74.

3. Do you think the Proposed Rule will have any negative impact on the structure of take-over bids in Canada? Please provide details.

Response:

In my opinion, the Proposed Rule will promote a more healthy structure of takeover bids in Canada by laying down ground rules and improving clarity.

4. Is the discretion given to a board of directors under the Proposed Rule appropriate?

Response:

Yes, in my opinion the discretion is appropriate. However, it can be made more effective by providing guidance on the considerations that must animate Rights Plans or the standards that should govern them.

5. In your view, would the increased leverage of target boards and greater shareholder control over the use of Rights Plans that would result under the Proposed Rule unduly discourage the making of hostile take-over bids? If you believe hostile take-over bids will be inhibited, please explain whether or not you support that impact or have concerns. If you believe that the Proposed Rule may unduly discourage hostile take-over bids, please explain how you would modify the Rule to address your concerns.

Response:

I believe the Proposed Rule, coupled with the management disclosures on reasons for implementing Rights Plans, recommended in the accompanying General Comments, will promote transparency. Coupled with the existing disclosure requirement applicable to bidders (Form 62-504F1), the rule will lead to greater openness from both sides – bidders and managements. This can, in turn, promote accountability by placing the actors under pressure to conform to the plans they announce and statements they make.

6. Do you believe that other changes or consequential amendments to applicable securities legislation will be necessary if the Proposed Rule is implemented? Please explain.

Response:

As I have explained in the accompanying General Comments, the Proposed Rule and the very concept of Rights Plans are quite removed from the passive role that is contemplated for the directors of target corporations in Ontario *Securities Act*, Part XX. It would be necessary to revamp the said legislative provisions to accommodate Security Holder Rights Plans. Similarly, there is a case for strengthening the position of dissenting shareholders by including them under the exit rights provided in the *Canada Business Corporations Act*, section 190. I have also referred to this in my response to Query #14, below.

Specific

7. The Proposed Rule contemplates that Rights Plans are effective following adoption provided that they are approved by shareholders within 90 days.

(a) Is this timing appropriate? Should issuers have more or less than 90 days to obtain shareholder approval of a Rights Plan?

Response:

The 90-day window is quite appropriate as it gives sufficient time to call a shareholders' meeting in companies facing takeover bids.

(b) Should the time period for shareholder approval be different depending on whether the Rights Plan was adopted in the absence of a proposed take-over bid or adopted in the face of a take-over bid?

Response:

It may not be necessary to make a distinction because companies not currently grappling with a takeover bid but wish to have a Rights Plan will be encouraged to include this in the agenda of their next annual shareholder meetings.

8. The Proposed Rule contemplates that a Rights Plan that is adopted after a take-over bid is made may remain in effect for a 90 day period pending security holder approval. We note that this 90 day period is longer than both the minimum 35 day period that a bid is required to be outstanding under applicable securities legislation and the 45 to 55 day period by which securities regulators have historically ceased traded a Rights Plan when successfully opposed by a bidder. Please provide your comments on the effect of this extension of the time.

Response:

The extended period of 90 days is appropriate for two reasons. Firstly, the target corporation needs sufficient time to call a special shareholder meeting. Secondly, it promotes uniformity. Please also see the response to Query #9, below.

9. While the Proposed Rule contemplates that Rights Plans are effective following adoption provided that they are approved by shareholders within the specified 90 day period, it does not mandate that a shareholder meeting be held within this 90 day period. This means, in effect, that a Rights Plan can remain in place for 90 days even if the board of directors choose not to hold a meeting. Should the Proposed Rule address the circumstance where an issuer does not take steps to call a shareholder meeting after a Rights Plan has been adopted?

Response:

In the Proposed Rule, the implication is clear that a Rights Plan will lapse if it is not approved by shareholders within 90 days of adoption. This can perhaps be made explicit. An important question, though, is about the consequences if the bid is thwarted within this period of 90 days

through implementation of the Rights Plan before it is approved by the shareholders and then directors of the target corporation decide not to seek shareholder approval for the Plan because they have already achieved their objective of defeating the bid. The result would be chaotic if actions taken under the unapproved Rights Plan are invalidated. An alternative would be to impose a penalty on directors for failure to place the Plan before the shareholders within 90 days of adoption. But this might require legislative sanction.

10. The Proposed Rule contemplates that all Rights Plans must be re-approved by shareholders by no later than the date of the issuer's annual meeting in each financial after the issuer first obtained security holder approval.

(a) Is this timing appropriate?

Response:

Yes. It is a healthy practice to seek periodic shareholder mandate to keep the Rights Plan in effect.

(b) Should Rights Plans that were adopted in the absence of a proposed take-over bid be effective for a longer period of time than Rights Plans that were adopted in the face of a take-over bid?

Response:

This is not advisable as it would make the regime more complex without conferring any significant additional advantage or benefit.

11. The definition of "security holder approval" in the Proposed Rule does not exclude votes cast by management of the issuer. Please explain whether or not you believe this is appropriate. Does your answer depend on whether the security holder approval is being sought in respect of a Rights Plan that was adopted in the absence of a proposed take-over bid as compared to one that was adopted in the face of a take-over bid? Would you like to see any other voting issues addressed?

Response:

As things stand, the Proposed Rule will not relieve directors of target corporations from the duty under the Ontario *Securities Act* to issue a circular with respect to the takeover bid. This will ensure disclosures about the personal interests of the directors and other executives in the bid (Form 62-504F3). If this is so, there seems to be no justification to exclude managements from voting on the Rights Plan since they are also security holders. In fact, voting by insiders can be valuable for its signalling effect. Also it may not make a difference whether the corporation is facing a takeover bid at the time of the vote because if this is so, then the vote is clearly because of the directors' hostility to the bid and their efforts to block it. Transparency is thus automatic and the fiduciary standards would take care of accountability. For these reasons, it is quite appropriate that managements are not excluded from participating in the shareholder vote on Rights Plans.

12. Section 3 of the Proposed Rule limits the effectiveness of rights plans to take-over bids and the acquisition of securities of an issuer by any person. Does this limitation unduly restrict the potential applications of rights plans? Should rights plans be permitted to be effective against irrevocable lock-up agreements?

Response:

This is quite appropriate as it ties into the goal of regulation, which is Rights Plans and hostile takeover bids. In regulating Rights Plans, the Proposed Rule rightly disallows the issue of securities under a Rights Plan when such issue is unconnected with a takeover bid or creeping acquisition.

13. Do you agree with the application of the Proposed Rule to material amendments to a Rights Plan? Do you believe that the nature of what may constitute a material amendment should be more fully addressed in the Proposed Rule or the Proposed Policy?

Response:

It would be challenging to come up with an effective and comprehensive definition of material amendments. At best, an illustrative list can be prepared with reference to past experience and current market practice. The future is clearly open and little can be done about it.

14. Should the Proposed Rule or Proposed Policy facilitate the ability of dissident shareholders or a bidder to challenge a pre-approved Rights Plan beyond the provisions of applicable corporate law by, for example, setting a minimum time period within which a meeting must be held or by dispensing with minimum ownership requirements?

Response:

This is among the challenges thrown up by the cleavage between corporate and securities law, with the latter occupying greater space in recent times. It is questionable how far safeguards for dissenting shareholders can be included in a set of rules framed by CSA to deal with Security Holder Rights Plans. It might be better to allow the issue to be dealt with in corporate law with its stable regime on minority shareholders and oppression. A useful option is to include opposition to Rights Plans for the purpose of exit rights of dissenting shareholders under section 190 of the *Canada Business Corporations Act*. This would be quite beyond the scope of the present exercise of CSA to develop regulation of Rights Plans, but it is a subject for future action and for making appropriate for recommendation to Corporations Canada/Industry Canada for legislative amendments to corporate statutes.

15. Section 5 of the Proposed Rule provides a general exception from security holder approval for new reporting issuers. Should this exception be limited or subject to conditions depending on the manner by which the issuer becomes a reporting issuer or the circumstances of the transaction (for example, if the new reporting issuer is a spin-out of another reporting issuer)?

Response:

Quite obviously, the Proposed Rule treats shareholder approval of Rights Plans as an important and necessary check on arbitrary use of directorial power and in promoting the market for corporate control. If this is so, there is no reason why new reporting issuer, of any kind, should be exempted from the rule. It would be justified to require companies entering the market with a pre-adopted Rights Plan to seek fresh shareholder approval after becoming reporting issuers. Apart from promoting uniformity and stability, this can also check temptations for prospective reporting issuers to craft Rights Plans that are not in accord with the genres of Plans commonly adopted by reporting issuers – for example, plans that are too restrictive or vest arbitrary powers in directors to take action to thwart takeover bids.

16. The Proposed Rule includes a transition provision in section 10. Is the time period contemplated in this provision appropriate?

Response:

It would be preferable to bring all Rights Plans, including existing Plans, under the Proposed Rule, as this will promote uniformity and clarity. This must, however, be balanced with the issue about hostile market response, especially if it means making amendments to Plans and/or seeking fresh shareholder approval.
