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# Contested Take-Over Bids – Offensive Strategies

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## Introduction

The prevalence of hostile take-over bids and other forms of contested M&A transactions continued a theme in the Canadian M&A markets in 2006 and the first part of 2007. The number and profile of these types of transactions have continued to grow despite the record number of transactions in the previous year.

Some of the more notable transactions include Alcoa Inc.'s hostile bid for Alcan Inc. and Saskatchewan Wheat Pool's bid for Agricore United (which was then topped by James Richardson International Limited, and then amended again once Saskatchewan Wheat Pool entered into an arrangement with James Richardson International to split up certain of Agricore United's assets). Other recent transactions include Harbinger Capital Partner's successful bid for Calpine Power Income Fund, Genzyme Corporation's successful bid for AnorMED Inc. and Avion Group hf's successful bid for Atlas Cold Storage Income Fund.

In addition, there have been an increasing number of topping bids in Canada, both in the context of an additional bidder making a hostile bid (such as Millenium Pharmaceutical's bid for AnorMED Inc. and James Richardson International's bid for Agricore United), and new bidders attempting to break up friendly supported transactions (such as Oxbow Carbon and Minerals Holding's successful attempt to acquire Great Lakes Carbon Income Fund following its friendly deal with Rain Commodities and Open Text Corporation's successful bid for Hummingbird Ltd. following its proposed transaction with Symphony Technology).

As well, we are now seeing aggressive suitors in Canada being able to impact the process that target companies employ through bear hug letters and public statements regarding the intentions of these potential bidders. One high profile example of this is the public disclosure made by Ontario Teachers Pension Plan Board regarding its change in investment intent relating to its holdings of shares of BCE Inc. which contributed to the review of strategic alternatives now underway by the board of BCE Inc.

This article focuses on the relevant strategic options and legal responsibilities of bidders. While my comments are based on Ontario securities legislation and regulation, the securities regimes of other provinces are quite similar in most respects. Indeed, our Canadian securities regulators have recently issued a proposed multilateral instrument, which when implemented will further harmonize the various provincial take-over bid rules.

## Prebid Strategies

### FORMING THE TEAM

Even before deciding on a bid strategy, it is essential to have a team of experienced financial and legal advisers in place. Financial advisers will value the target company and may be asked to provide the bidder's board of directors with a fairness opinion regarding the offer price. In addition, they frequently organize the solicitation process for the tender of shares. Legal counsel will assist in evaluating publicly available information regarding the target company and be responsible for ensuring that the bidder complies with securities law in all relevant jurisdictions. In addition to financial and legal advisors, it will often be advisable to retain experienced investor relations advisors in hostile situations.

### MAKING AN UNSOLICITED OFFER

The decision whether to proceed on a "friendly" or "hostile" basis will often turn on the following factors:

#### Availability of Information

Potential hostile bidders must carefully consider whether they can get enough information about the target in the likely event that full cooperation is not forthcoming from its management and board. Because Canada has an extensive corporate public disclosure regime (similar in substance to the requirements of public companies in the United States), publicly available information will sometimes be sufficient. Thus we frequently see hostile bids for natural resource companies whose primary assets consist of reserves that are publicly disclosed and easily comparable with those of other companies in the industry. In many cases, however, undisclosed financial and operating information will be significant to a purchaser and may make an unsolicited bid less attractive.

#### Retention of Management

If retention of current management is desirable, it may be preferable to proceed by way of a friendly bid. In some industries (e.g. high technology) retention of management may be more vital to the target's ongoing success than in others (e.g. natural resources).

#### Types of Shareholder

The profile of the target company's shareholders is another important consideration. The most likely target of an unsolicited offer is one whose shares are widely held, with no single controlling shareholder. A company with a large shareholder, especially one that is actively involved in management or with representatives on the board of directors, is a viable candidate for a hostile bid only with the support of that shareholder.

## TAKING A TOEHOLD

### Benefits and Risks

Once the decision to launch an unsolicited take-over bid has been made, the prospective bidder may wish to accumulate shares of the target company before making public disclosure of its intention. There are two main reasons to take such a "toehold:" (1) public disclosure of a potential change of control transaction may raise the share price of the target, making it cost-effective to buy some shares before disclosing, and (2) if the target company finds a "white knight" to bid even more money per share than the first bidder offers, the first bidder can use the sale of its pre acquired shares to recoup the costs of its bid. But the strategy has its risks:

- The bid may be abandoned, or successfully defended against, so as (1) to leave the share price at or beneath the price at which the toehold was acquired and (2) to leave the bidder holding a significant number of shares that may be difficult to sell no matter their price.
- Share purchases may increase the perception of hostility, which may be important if the bidder wishes to retain the possibility of proceeding on a friendly basis until later in the process.
- Someone may notice a significant purchase and thus be tipped off that the bidder, or someone in general, is interested in making a bid.
- Too much buying may bid up the price of the target company's stock, raising the price at which a successful bid would have to be made.
- Any shares acquired prior to the date that the formal take-over bid circular is mailed will not be counted for purpose of majority-of-the-minority vote in second-step transactions or for determining whether any shares not deposited to the take-over bid can be compulsorily acquired following the take-over bid (such an acquisition can be effected automatically if more than 90 per cent of the shares not owned by the bidder on the date that the formal take-over bid offer and circular were mailed are deposited to the bid).

There are limits on the ability of a prospective acquiror to take a toehold. Relevant take-over bid rules include the following:

### Early Warning Disclosure

Any person who acquires beneficial ownership of (or the power to exercise control or direction over) 10 per cent or more of any class of voting or equity securities of an issuer must promptly issue a press release to that effect and, within two business days, file an Early Warning Report with the applicable securities regulators. If there is already a formal take-over bid outstanding for the shares of that target company, the disclosure threshold is lowered from 10 per cent to 5 per cent. Both the press release and the early warning report must, among other things, identify the offeror and state its intentions in purchasing the shares. If confidentiality is a priority, it is therefore crucial not to cross these shareholding thresholds.

### Prebid Integration

Prebid integration is essentially an attempt to ensure that prebid buying cannot be used as a backdoor method of introducing certain types of unfairness or favouritism into a bid process. Subject to the exceptions described below, the take-over bid rules require that in any formal take-over bid (i.e. an offer made pursuant to a take-over bid circular or through the

facilities of a Canadian stock exchange), the bidder must offer at least the same consideration that the bidder (or any person acting jointly or in concert) paid for any shares that it purchased in the 90 days prior to the date of the formal take-over bid. In addition, the bidder must offer to acquire under the take-over bid that percentage of securities of the class subject to the bid that is at least equal to the highest percentage that the number of securities acquired from a seller in the 90 days prior to the formal take-over bid was of the total number of securities of that class beneficially owned by that seller at the time of the purchase from that seller.

There is an exception to these prebid integration rules for trades that are made in the normal course on a published exchange (i.e., a stock exchange), if (1) neither the purchaser nor the seller solicits or arranges the trade, and (2) any broker in the trade performs only "customary functions" for reasonable fees. These rules raise interpretive issues (e.g. the meaning of "customary functions") and there are also questions about how the rules are designed to work when the bidder offers its own shares as consideration in any formal take-over bid.

### Insider Trading and Tipping

A prospective bidder is not precluded by insider trading rules from acquiring a toehold in the target company. The insider trading prohibition applies only to a "person or company in a special relationship" with the target. A bidder does not fit within the prescribed definition of "person or company in a special relationship" with respect to its target, although (importantly) insiders, affiliates and associates of the bidder are expressly caught.

In addition, "tipping" prohibitions restrict any person or company in a special relationship with a reporting issuer from disclosing to any other party any material fact or material change with respect to that issuer that has not been generally disclosed. In addition to being prohibited from trading, therefore, a bidder's insiders, affiliates and associates must not disclose to anyone that the bidder has decided to make a take-over bid for a target company.

### APPROACHING THE TARGET COMPANY

Let us suppose that, as a prospective bidder, you have formed the team, evaluated the target company as to the extent possible, accumulated a toehold position and are ready to proceed. How do you announce your intention? Usually the first call is to the target company itself, but the manner of doing so varies from situation to situation.

One method that may be considered is to send a "bear hug" letter to the target company. This form of letter is designed to exert pressure the target's board of directors to negotiate with the bidder and give it access to undisclosed information. Target companies feel "squeezed" by bear hugs because a refusal to negotiate might lead the bidder to abandon its bid, leaving the target's board members potentially in breach of their fiduciary duty to shareholders. In addition, the target company may be able to extract a better deal if it responds positively to the bear hug, a potential advantage that a rejection may jeopardize.

Another approach is simply to announce the unsolicited bid, preceded by a brief courtesy call to the target company. However it chooses to proceed, the bidder should be prepared to announce its intention as soon as it makes its first approach to the target company. It cannot be assured of confidentiality once it has done so: the target company is free to disclose the

details of any approach, and in any event if a hostile take-over is to be launched it will probably need to be announced shortly after any such visit.

### The Formal Take-Over Bid Offer

In Canada, securities law rules relating to formal take-over bids are the same for unsolicited offers as they are for consensual offers. In summary, they can be described as follows:

#### METHOD OF LAUNCHING THE OFFER

Take-over bids may be formally launched by publishing an advertisement containing a summary of the bid in a major daily newspaper or by mailing the take-over bid circular to shareholders. If the bid is launched by advertisement, the take-over bid circular must first be filed with the securities regulatory authorities and a copy of it delivered to the target company. In addition, the bidder must mail the take-over bid circular to the shareholders of the target company within two business days of receipt of a list of shareholders. In a hostile bid, it is common for bids to be launched by way of advertisement, since this is quicker than having to wait for the target company to deliver its list of shareholders, which can frequently take 10 days from the date that the list is requested.

#### DISCLOSURE DOCUMENT

All of the terms and conditions of the offer will be set out in a take-over bid circular that is ultimately mailed to shareholders of the target company. If the bidder is offering its securities as part (or all) of the consideration, the take-over bid circular will have to provide prospectus-level disclosure relating to the bidder.

#### OFFER PERIOD

The minimum time that an offer may remain open is 35 calendar days from the launch date. Normally, a bidder will keep the offer open only for the minimum period of time, unless there are any regulatory consent that must be obtained as a condition to closing that are likely to take a longer period of time. Occasionally, where a target company has a shareholder rights plan (i.e. a poison pill), a hostile bidder will make its offer a "permitted bid" within the meaning of the rights plan, which will require (among other things) that the bid be outstanding for a period of time that is longer than the statutory minimum (frequently 45 or 60 days).

#### MINIMUM TENDER CONDITION

In most cases, the objective of the bidder is to obtain 100 per cent of the common shares of the target company, and therefore be able to cause the target company to cease to be a reporting issuer. There are generally two ways to do this. Where a bidder acquires through the take-over bid more than 90 per cent of the shares of the target company that the bidder did not

own at the start of the bid, the bidder may take advantage of the "compulsory acquisition" provisions of most corporations statutes. However, where a bidder falls short of that threshold but still acquires enough shares so that it owns more than 66 2/3 per cent of the shares of each class, it can be assured of being able to effect a squeeze-out transaction (i.e., through an amalgamation, consolidation or capital reorganization) that will accomplish the same objective. In a hostile situation in which the target has no say in the bid conditions, it is more common to see minimum tender conditions of 90 per cent, since the bidder is always entitled to waive the condition and resort to a squeeze-out if necessary, provided that it reaches the 66 2/3 per cent standard.

#### OTHER CONDITIONS

It is common for unsolicited bidders to include broadly-worded conditions giving themselves wide discretion to determine whether the conditions have been satisfied. These conditions can include access to any data room made available to others, absence of any material adverse change, receipt of all regulatory approvals and even, in some bids, successful completion of due diligence. As a highly conditional bid may be taken less seriously by the target company and shareholders generally, a reasonable balance must be struck. One item that may not be the subject of a condition is a bidder's financing for the acquisition, since securities legislation requires that bidders make adequate arrangements to ensure that funds required to pay for the cash portion of the consideration have been obtained prior to launching a bid. Despite this requirement to have made "adequate arrangement", financing arrangements may be subject to conditions provided that the offeror reasonably believes the possibility to be remote that such conditions will not be satisfied if the conditions to the bid are satisfied or waived.

#### EXPIRY OF THE OFFER/EXTENSION OF THE OFFER

If the bid conditions have been satisfied or waived by the bidder at the expiry of the bid, the bidder is required to take up and pay for the shares deposited under the bid within 10 days of the expiry of the bid. The bidder may be required to pay for the shares even earlier if it takes up the shares before the end of the 10-day period.

If any or all of the bid conditions have not been satisfied or waived, the bidder is entitled to extend the offer for at least 10 calendar days. Where all the bid conditions have been satisfied, the bidder is also entitled to extend the offer, but only after taking up and paying for the shares that have been deposited prior to the extension.

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