

Legal update

Private placements as a defence to take-over bids

November 2016 Securities litigation

The Ontario Securities Commission (OSC) and British Columbia Securities Commission (BCSC) recently released a noteworthy decision marking the first instance since changes to the regime governing take-over bids became effective in May 2016 in which Canadian securities regulators considered whether a contemplated private placement is an inappropriate defensive tactic.

The decision *In the Matter of Hecla Mining* also includes useful guidance concerning the application of the OSC and BCSC's (collectively, the Commissions) public interest jurisdiction in these circumstances.

Background to the dispute

Dolly Varden Silver Corporation is a junior mineral exploration company whose shares are listed on the TSX-V. It is a reporting issuer in BC, Ontario and Alberta.

Hecla Mining Company is a US silver producer that is a reporting issuer in all Canadian provinces and territories. Through a wholly owned subsidiary, Hecla beneficially owned and controlled more than 10% of the issued and outstanding securities of Dolly Varden.

In June 2016, Hecla announced its intention to make an "insider offer" as defined in Multilateral Instrument 61-101: *Protection of Minority Security Holders in Special Transactions* to purchase all outstanding common shares of Dolly Varden.

Shortly thereafter, Dolly Varden announced it would pursue a private placement financing due to its precarious financial state. Hecla's formal offer, commenced on July 8, was conditional on the private placement not proceeding.

At the same time, Hecla applied to the BCSC to cease trade the private placement as an abusive defensive tactic under National Policy 62-202 – Take-Over Bids – Defensive Tactics (NP 62-202).

One week later, Dolly Varden applied to the OSC seeking relief under sections 104 and 127 of the Ontario *Securities Act*, to cease trade the offer on the basis that Hecla's take-over bid circular did not include a formal valuation as required by MI 61-101. Although the BCSC had not adopted MI 61-101, Dolly Varden's application was also filed with the BCSC seeking the same relief.

The BCSC and OSC held simultaneous hearings on the Hecla and Dolly Varden applications, on the basis that it was in the public interest for them to strive to achieve consistency in decision making due to the matters involved, and in the interests of efficiency. Each hearing panel was separately constituted and rendered its own decision.

The Commissions' decisions

Both Commissions denied the Hecla application.

The Commissions observed that a securities issuance may, in some circumstances, constitute a defensive tactic attracting regulatory scrutiny because it may frustrate the ability of shareholders to respond to a bid. Applying a list of non-exhaustive factors relevant to that inquiry, both regulators determined that Dolly Varden's private placement had been instituted for non-defensive business purposes and accordingly the principles in NP 62-202 were not engaged. Dolly Varden had been contemplating equity financing in advance of Hecla's bid and the size of the private placement was commensurate with its capital requirements.

The Commissions also chose not to interfere under their broader public interest mandate, making note of the market reality that listed junior mining companies may often engage in dilutive equity transactions for *bona fide* business purposes. The Commissions showed deference to the business judgement of Dolly Varden's board in deciding to pursue to a private placement in light of the company's circumstances, observing that public confidence in the capital markets required them to "consider the responsibilities of boards of directors in implementing corporate actions."

The Commissions further acknowledged it is not the role of securities regulators to offer redress for actions that may fall short of corporate law standards or to duplicate civil remedies, such as for oppression. Private placements should be blocked by securities regulators only where there is "clear abuse of the target shareholders and/or the capital markets."

Commissions' divergence

However, the Commissions diverged in their disposition of the Dolly Varden application.

The OSC granted Dolly Varden's application under s. 127 of the Ontario *Securities Act* to cease trade the Hecla offer until the offer satisfied the requirements of 61-101, including the preparation of a formal valuation of the offeree securities and inclusion of the valuation as an addendum to the offer.

Subsection 2.3(1) of MI 61-101 requires, among other things, that the offeror in an insider bid obtain a formal valuation at its own expense, supervised by an independent committee of the target. The purpose of the requirement is to address any asymmetry of information between the insider and other shareholders, and allow non-insider shareholders to make an informed decision about whether to tender to the insider bid. Hecla's bid was non-compliant, and it failed to demonstrate that it qualified for an exemption. The need for a formal valuation was not a "close call."

The BCSC declined to make such an order. MI 61-101 had not been adopted by the BCSC. The BCSC observed that while that instrument did apply to issuers listed on the TSX-V and it is in the public interest to support compliance with exchange policies, the exchange's policy applied only to Dolly Varden as the issuer and not to Hecla.

The BCSC also was not inclined to exercise its general public interest jurisdiction to cease trade the Hecla offer until a valuation could be prepared. Such an order could delay the offer and potentially result in its termination. The potentially significant impact on Dolly Varden shareholders advocated for a "narrow application of the public interest jurisdiction," which would require a finding that the impugned conduct constitutes an abuse of the capital markets or investors. In light of the valuation exercise undertaken by Dolly Varden's board of directors resulting in its pricing of the private placement at a price lower than the price of the offer, the BCSC concluded that a formal valuation by Hecla would not offer better insight into the valuation of the Dolly Varden shares.

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The author would like to thank articling student Brian Peebles for his assistance in preparing this legal update.

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