

Defensive Tactics and Deal Protection Techniques: The Canadian Perspective

RICHARD R. CLARK (rclark@stikeman.com)
STIKEMAN ELLIOTT LLP

Committee Forum: An International Perspective on M&A Deal Protection
International Business Law Committee, Business Law Section
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Richard E. Clark, BAsC (Chem Eng.), B Comm, MBA, JD, is Chair of the Toronto M&A / Private Equity Practice Group of Stikeman Elliott LLP and Chair of the International Business Law Committee of the Business Law Section of the American Bar Association. The author gratefully acknowledges the invaluable assistance, insight and experience of Dee Rajpal, a Partner at Stikeman Elliott LLP, in the preparation of this paper.

TABLE OF CONTENTS

1.0	Introduction.....	1
2.0	Statutory and Regulatory Background	2
	(1) Duty to Manage: s. 102, CBCA	3
	(2) Duty of Loyalty – The Fiduciary Obligations: s. 122(i), CBCA.....	3
	(3) Duty of Care: s. 122(1)(b), CBCA.....	5
3.0	Review by the Courts and Regulatory Authorities	6
	(1) The Traditional Canadian Approach - The “Proper Purpose Doctrine”	7
	(2) The “Business Judgement Rule”	8
	(3) The American Approach	10
	(4) NP 62-202.....	12
4.0	Defensive Tactics	14
	(1) Shareholder Rights Plans (“Poison Pills”)	16
	(2) Other Structural Defences	17
	(3) Standstill Agreements.....	18
	(4) Reverse Break Fee.....	19
	(5) Go-Shops.....	20
	(6) Material Adverse Change	21
5.0	Deal Protection Measures.....	23
	(1) Exclusivity (Non-Solicitation).....	24
	(2) Right to Match.....	24
	(3) Force the Vote	25
	(4) Break Fees	25
	(5) Expense Reimbursement.....	26
	(6) Lock-up Agreements.....	26
	(7) Stock and Asset Options.....	27
6.0	Conclusion.....	28

ADDENDA

EXHIBIT “A” SAMPLE CLAUSES

EXHIBIT “B” ASSESSMENT OF TAKEOVER DEFENSES: CHARTER AND
BYLAWS

1.0 Introduction

In a change of control transaction involving a Canadian publicly-listed target (whether by way of take-over bid, plan of arrangement, amalgamation or otherwise), the role of the board of directors of the target is critical. Such board's response in employing defensive tactics or providing deal protection to a potential acquiror is guided and limited by a number of factors. In summary, in the context of a change of control transaction in Canada:

- (a) The fiduciary duties of directors and the other related duty of care and duty to manage the corporation are imposed by statute and, in some instances, are broader than those imposed under the common law or by equity.
- (b) The securities regulators have clearly stated that securities legislation has, as its primary objective, the protection of the bona fide interests of the shareholders of the target company.
- (c) As a result of the foregoing and the resulting jurisprudence, the directors of a Canadian target company are limited both in the defensive tactics they can employ to fend off an unwanted suitor and the deal protection devices they can provide to a potential acquiror.
- (d) The "just say no" defense is very difficult to rely upon in Canada and once a Canadian target is "put in play" it is highly likely a transaction will result, often with a "white knight".
- (e) As in the U.S., the "process" adopted by the board is extremely important in establishing whether the members of the board have satisfied their fiduciary and other statutory duties. Such process would include, inter alia, the possible formation of a special committee, the timing of establishing such a committee, the independence of committee members, the timelines of responses to bidders and the control and use of company assets, such as confidential information.
- (f) Although hostile take-over bids may be making a comeback, for a variety of reasons a significant number of change of control transactions are effected in Canada by way of a statutory plan of arrangement. Such a plan of arrangement requires, among other things, a fairness hearing as an integral part of obtaining court approval.
- (g) Although the Canadian courts have expressly rejected the U.S. Revlon duty (the duty on a board to maximize shareholder value in a change

of control transaction), the Canadian approach may best be described as a modified-Revlon duty whereby the board of a Canadian target has a duty to achieve the best value reasonably available to shareholders in the circumstances.

- (h) The Canadian courts have endorsed the U.S. “business judgement” doctrine such that the courts will generally defer to the decision of an informed board made honestly, prudently, in good faith and on reasonable grounds.
- (i) Canadian corporate legislation provides for the very broad “oppression remedy” whereby a security holder, creditor or other complainant can seek redress through the courts for acts or omissions of a corporation that are “oppressive or unfairly prejudicial to or that unfairly disregard” their interests. The fairness hearing required to approve a plan of arrangement noted above often provides the perfect setting for an oppression claim.
- (j) For the reasons noted above, other than negotiated standstill agreements, structural techniques (such as shareholder rights plans and charter and bylaw restrictions) either are not used or are relatively benign. Tactical defenses (such as “just say no”, capital restructuring, “Crown jewel” options and similar techniques) are not widely used in view of the fact they must have a demonstrable business purpose and may open the action to claims by shareholders and/or regulators. A negotiated support (or “merger”) agreement with a white knight is a much more common response.
- (k) Deal protection devices employed in Canada would be more in line with U.S. practice and would include break fees, non-solicitation covenants and lock-up agreements with key shareholders.

2.0 Statutory and Regulatory Background

In order to provide a contextual background for defensive tactics and deal protection techniques in change of control transactions, the following is a general overview of the legislative and regulatory environment in Canada, including directors’ obligations. Corporate statutory references will be to the *Canada Business Corporations Act* (“CBCA”), although most Canadian corporate statutes (many being modelled on the CBCA), including the *Business Corporations Act* (Ontario) have identical or comparable provisions.

Unlike in many jurisdictions, the duties and obligations of directors, including their fiduciary obligations as individuals, are codified in the CBCA. These basic duties are as follows:

- the duty to manage the corporation
- the duty of loyalty to the corporation (the fiduciary obligations)
- the duty of care

(1) Duty to Manage: s. 102, CBCA

The directors have a duty to manage, or supervise the management of, the business and affairs of the corporation. This statutory duty requires directors to be pro-active and thus the board may not delegate completely the review and evaluation of potential transactions to its financial advisors or professional advisors or accept without question their conclusions. Each board member must inform himself or herself fully of all material information reasonably available, and must understand and test the advice of advisors.

(2) Duty of Loyalty - The Fiduciary Obligations: s. 122(i), CBCA

In managing the business and affairs of a corporation, each director must act honestly and in good faith with a view to the best interests of the corporation. This duty of loyalty requires each director to act fairly and impartially, and not to subordinate the interests of the corporation to such director or other parties.

This duty generally requires the full disclosure of director's dealings with the corporation, the avoidance of possible conflicts of interest between the director and the corporation with respect to transactions in which the corporation is involved and the furtherance of the corporation's interests over the director's own selfish interests, financial or otherwise. This is often achieved by establishing a "special committee" of independent directors to minimize conflicts or the appearance of conflicts. In addition, such special committee will often retain its own independent legal and financial advisors.

As stated in *CW Shareholdings Inc. v. WIC Western International Communications Ltd.*, (1998), 39 O.R. (3d) 755 (Ontario Court General Division) ("*WIC Western*") (at p. 769):

"Retaining independent legal and financial advisors, and the establishment of independent or special directors' committees to assess and respond to the hostile bid, are the classic mechanisms to which boards of directors have traditionally resorted in order to cope with their difficult duties and conflicting position.... Resort to these devices enables the directors to investigate and consider the circumstances - including the triggering bid, and the various alternatives available to the corporation in respect of it, having regard

to the interests of the shareholders - with a degree of independence. In the end they must make a decision and exercise their judgement in an informed and independent fashion, after a reasonable analysis of the situation and acting on a rational basis with reasonable grounds for believing that their actions will promote and maximize shareholder value..."

In the context of a change of control transaction involving a corporation, this fiduciary duty has been interpreted to mean that directors must act primarily in the best interests of the shareholders. However the Supreme Court of Canada in *Peoples Department Stores (Trustee of) v. Wise* (2004), 49 B.L.R.(3d) 165 (S.C.C.) ("*Peoples*") has indicated that in using their skills for the benefit of the corporation, directors must be careful to attempt to act in its best interest by creating a "better corporation" and not to favour any one group of stakeholders. The Supreme Court went on to say that in determining whether directors are acting with a view to the best interests of the corporation, it may be legitimate, given all of the circumstances of a given case, for the board of directors to consider, inter alia, not only the interests of shareholders but also employees, suppliers, creditors, consumers, governments and the environment.

Under Canadian corporate law, shareholders, including controlling shareholders, do not generally owe fiduciary obligations to other shareholders. However, the oppression remedy may come into play if it can be proven that the actions of the majority shareholders, for example, is oppressive or is unfairly prejudicial to the minority shareholders.

It should also be noted that many change of control transactions in Canada are implemented through a statutory plan of arrangement which requires a fairness hearing, and the court may make any interim or final order it thinks fit: s. 192(4), CBCA. The directors are also required to consider the possible application of the oppression remedy: s. 241, CBCA. The test for oppression includes, among others, whether (i) any act or omission of the corporation or any of its affiliates effect a result, or (ii) the powers of the directors of the corporation or any of its affiliates are or have been exercised in a manner, that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer, and the court may make an order to rectify the matter complained of.

The oppression remedy is the weapon of choice in many contested change of control transactions and the jurisprudence is constantly evolving. However, it is clearly not mandatory in all cases to consider the interests of all of such stakeholders and in seeking to further the interests of the corporation, the

interests of shareholders would generally remain central in change of control circumstances.

The Supreme Court of Canada has just recently had to consider how far a board must go in taking into account the interests of stakeholders, other than shareholders, namely a group of bondholders who had successfully challenged a plan of arrangement which involved taking BCE Inc. private in a C\$52 billion leveraged buyout. In *BCE Inc. et al. v. A Group of 1976 Debentureholders et al. and Others* (unreported, June 20, 2008), the Supreme Court set aside the decision of the Quebec Court of Appeal and thereby reinstated the decision of the trial judge approving the BCE plan of arrangement. Among other things, the Supreme Court had to determine, notwithstanding the absence of appropriate protective language in their trust deeds and other documents (such as change of control events of default), whether the debentureholders could have “reasonably expected” that their interests should trump those of the shareholders – even where such debentureholders relied upon the oppression remedy in the forum of a fairness hearing required to approve the plan.

(3) Duty of Care: s. 122(1)(b), CBCA

Each director must exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. In addition, the CBCA encourages reliance on the advice of professionals where the directors do not have the requisite skill.

The Canadian courts are reluctant to substitute their own business judgement for that of directors who have acted in good faith. However such courts, as elsewhere, will scrutinize the process by which the directors make their decisions and the apparent objectives of their action.

Generally, to satisfy the duty of care, the directors of a Canadian corporation must be in a position to demonstrate that their decision was properly informed and fully considered. As in the U.S., Canadian courts have tended to examine the degree of formality (that is, the process) adopted by directors in considering a change of control transaction.

In the *Peoples* case, the Supreme Court indicated that the duty of care is to be determined objectively. That is, the duty of care is to be judged on the basis of what the director or officer in question ought reasonably to have known, rather than on the basis of his or her actual subjective knowledge (no apparent “professional director” category). While this means the lack of experience of a director will not serve to lower the standard of care, it also arguably suggests that the duty of care might be relaxed somewhat for

directors (such as professionals or experienced business persons) who possess special skills or expertise.

If correct, this latter interpretation would be inconsistent with recent case law emerging out of the Delaware courts. For example, in *In re Emerging Communications Inc. Shareholder Litigation* (Del. Ch. June 4, 2004), the Delaware court ruled that officers and directors with “specialized expertise or knowledge” can be held to a higher standard than other directors. While the state of the law is unclear, a higher standard of care may be expected of persons who, by the nature of their professions, are well versed and sophisticated in corporate procedures than those who possess lesser business qualifications and experience. The *Peoples* case also stands for the proposition that the duty of care extends at least to creditors and potentially to other stakeholders, rather than solely to shareholders.

3.0 Review by the Courts and Regulatory Authorities

Compared to the American (particularly, the Delaware) experience, there is a relative dearth of Canadian cases dealing with the conduct required of directors to discharge their statutory duties in the context of a change of control transaction. As there is a plethora of American jurisprudence in the area, recent Canadian cases have sought guidance from, and, in some cases, adopted principles similar to those derived from the American jurisprudence.

There appear to be a number of complementary approaches, namely: (i) that traditionally taken by the Canadian courts (the “**proper purpose**” doctrine), (ii) that of the American (particularly, the Delaware) courts (the “**business judgement**” rule), (iii) a somewhat-modified American-style approach taken in two leading Ontario cases and recently adopted by the Supreme Court, albeit in a different context, and (iv) that taken by the Canadian securities regulators under National Policy Statement No. 62-202 (“**NP 62-202**”). While many of the Canadian and American judicial decisions, as well as NP 62-202, deal primarily with defensive measures taken by directors in response to hostile take-over bids, conclusions can still be drawn as to what the board should do in respect of granting deal protection mechanisms.

As a general observation, the traditional approach of the Canadian courts appears to differ from that taken by the Delaware courts. In earlier decisions, Canadian courts adhered to a doctrine known as the “proper purpose doctrine”. In essence, the doctrine involves an inquiry into whether the directors of the target company, in their responses to a change of control transaction, were motivated by an acceptable or inappropriate purpose. The American approach involves a greater assessment of the actual consequences of particular actions and decisions made by directors than the Canadian approach. In two Ontario decisions, the courts have

adopted an approach based on the “business judgement rule” which is rooted in the approach taken by the American courts. This approach has been adopted by the Supreme Court in the *Peoples* case. In essence, the “business judgement rule” provides that where business decisions have been made honestly, prudently, in good faith and on reasonable and rational grounds, the courts will not intervene and substitute their judgement for that of the target board.

Generally, under all three approaches, the courts are reluctant to interfere to usurp the board’s function in managing the corporation and, in most cases, will uphold challenges to the actions of directors of the target only where there is evidence of self-interest, lack of care, bad faith or unreasonableness. Notwithstanding the different labels, the American and Canadian approaches may involve distinctions without differences.

While the American and Canadian approaches focus, to differing extents, on the motivation of the target directors, the Canadian securities regulators under NP 62-202, have dwelt almost entirely on the consequences of the defensive actions of directors facing a take-over bid.

(1) The Traditional Canadian Approach - The “Proper Purpose Doctrine”

In determining whether directors have discharged their fiduciary duties in the context of a change of control transaction, in addition to the adoption of the “business judgement rule”, traditional Anglo-Canadian cases have focused on the “proper purpose doctrine”. As explained in decisions such as *Teck Corporation v. Millar* (1972), 33 D.L.R. (3d) 288 (B.C. S.C.), this essentially involves an inquiry into the primary purpose of the directors in responding to the change of control transaction, and whether or not the primary purpose constituted one that was acceptable (such as maximizing shareholder value) or unacceptable (i.e. simply preventing a change of control, board or management entrenchment or some other improper purpose). In resolving this question, courts looked at whether the directors acted in good faith and on what they reasonably believed to be in the best interests of the corporation.

Regardless of the approach taken, Canadian courts will not uphold defensive tactics demonstrably aimed at management or director self-entrenchment. However, where a court is satisfied that the directors have acted in the best interests of the corporation and in good faith, it is not fatal if they also benefit as a result. Further, directors cannot act to deny shareholders the ability to make a decision with respect to a take-over bid. The court in the case of *347883 Alberta Ltd. v. Producers Pipelines Inc.* (1991), 80 D.L.R. (4th) 359 (Sask. C.A.) noted that, when faced with an unwelcome take-over bid, the role of target directors is to advise shareholders on whether to accept or reject the bid. In effect, the role of directors becomes that of “gate-keepers”, to provide

information to shareholders to assist them in making the right decision and to facilitate the process. This reflects the policy considerations set out in NP 62-202 and the role of the take-over bid provisions in provincial securities legislation.

(2) The “Business Judgement Rule”

Two relatively recent Ontario cases, *WIC Western* and *Pente Investments Management Ltd. v. Schneider Corp.* (1998), 42 O.R. (3d) 177 (Ont. C.A.) (“*Schneider*”) have adopted another approach based on the “business judgement rule”. In essence, this rule provides that where business decisions have been made honestly, prudently, in good faith and on reasonable and rational grounds, the courts will not interfere to usurp the board’s function in managing the corporation. If the directors have made a reasonable decision, but not necessarily a perfect decision, the courts will not substitute their opinion for that of the board, even though subsequent events may have cast doubt on the board’s determination. As stated in *WIC Western* (p.774):

“In assessing whether or not directors have met their fiduciary and statutory obligations, as outlined earlier in these Reasons, Canadian courts have generally approached the subject on the basis of what has become known as the “business judgement rule”. This rule is an extension of the fundamental principle that the business and affairs of a corporation are managed by or under the direction of its board of directors. It operates to shield from court intervention business decisions which have been made honestly, prudently, in good faith and on reasonable grounds. In such cases, the board’s decision will not be subject to microscopic examination and the Court will be reluctant to interfere and to usurp the board of director’s function in managing the corporation.”

This approach was adopted by the Supreme Court in *Peoples*, albeit in a different context. In the *Peoples* case, the Supreme Court affirmed that in determining whether the directors have breached their duty of care, the courts “do not demand perfection, but defer to business decisions made by the directors, so long as the decision was reasonable”. The duty of care is not breached if the directors acted “prudently and on a reasonably informed basis.”

Although these cases apply a different approach than the “Unocal test” under Delaware law, both approaches have common requirements in that the court must be satisfied that the directors have acted reasonably and fairly.

In both the *WIC Western* case and the *Schneider* case, the courts held that as the directors had taken steps to maximize shareholder value that were

reasonable in the circumstances, they were not in breach of their fiduciary duties. These cases provide valuable examples of the steps that may be reasonable, depending on the circumstances.

However, the *Repap* decision (*UPM- Kymmene Corporation v. UPM- Kymmene Miramichi Inc.* (2004), 250 D.L.R. (4th) 526 (C.A.)) demonstrated that there are limits as to how far the courts will go in deferring to the business judgement of directors and provided some useful guidelines for directors to demonstrate that they have been scrupulous in their deliberations and shown diligence in arriving at their decision.

In the *Repap* case, the court set aside an extraordinarily generous, executive compensation arrangement entered into by a cash-constrained company for the newly-created position of Executive Chairman, which arrangement included shares and options amounting to 13.4% of the company's stock, a multi-million dollar market capitalization bonus and a "single-trigger" change of control severance package estimated to be worth \$27 million. Madame Justice Lax reiterated the preference of the courts not to second guess the decisions of board of directors but stated that "although Board decisions are not subject to microscopic examination with perfect vision of hindsight, they are subject to examination".

The court then proceeded to analyse in detail the egregious facts in that case, which included the fact that only two of the three members of the compensation Committee were present when the arrangement was approved, following only ten minutes of discussion; a first board meeting was contentious and did not approve the arrangement but a newly-constituted board only deliberated 30 minutes before approving the arrangement; the court found that the company didn't need an Executive Chairman; the court found that the board didn't understand how the compensation arrangements worked; and the board relied inappropriately on a highly-qualified opinion from a compensation expert delivered only at the second directors' meeting. The court concluded that the board had breached its duty of care by failing to make its decision on an informed and reasoned basis. The directors could not rely on the business judgement rule because, in effect, they had not exercised any or very little business judgement in the circumstances. Once again, the court confirmed the importance of the process (or lack thereof) adopted by the board.

(3) The American Approach

(a) The “Revlon” Duty

Formulated in the Delaware decision of *Revlon v. MacAndrews & Forbes Holdings*, 506 A.2d 173 (1986) (Delaware Supreme Court), the “Revlon” duty suggests that where a sale or change of control of the corporation is “inevitable”, the duty of the target directors changes from that of protector of the corporate interest to “auctioneer” of the corporation in order to obtain the highest value reasonably available for all shareholders. Although Canadian courts have not imposed a “Revlon” duty in take-over bid situations, the Canadian decisions in the *WIC Western* and *Schneider* cases, and the approach in NP 62-202 appear to endorse the view that directors must make efforts to achieve the best value reasonably available to the shareholders in the circumstances.

Under the “Revlon” duty, once a corporation has been “put in play”, directors may not act to prevent the sale or change of control of the corporation. Instead, they must actively supervise the sale process for the purpose of enhancing shareholder return. Although the American decisions do not require a board to run an auction for the corporation, depending on the circumstances, an auction-type process may be a prime indicator that shareholder value has been maximized. The court said (p.182):

“The duty of the board has thus changed from the preservation of Revlon as a corporate entity to the maximization of the company’s value at a sale for the stockholder’s benefit. This significantly altered the board’s responsibilities... the directors’ role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company.”

In the Canadian decision of *Schneider*, the court stated that when it becomes clear that a corporation is for sale and there are several bidders, an auction is an appropriate mechanism to ensure that the board of a target company acts in a neutral manner to achieve the best value reasonably available to shareholders in the circumstances. When the board has received a single offer and has no reliable grounds upon which to judge its adequacy, a canvass of the market to determine if higher bids may be elicited is usually appropriate, and may be necessary, depending on the circumstances. The court said (p.182):

“The decision of the Delaware Supreme Court in *Paramount v. Time* recasts the “Revlon” duty to a duty to seek the best value reasonably available to shareholders in the circumstances. This is a more flexible standard, which recognizes that the particular circumstances are important in determining the best transaction available, and that a board is not limited to considering only the amount of cash or consideration involved as would be the case with an auction. In that case, the Delaware Supreme Court held that the fact that a corporation has been “put in play” does not oblige directors “to abandon a deliberately conceived corporate plan for a short term shareholder profit unless there clearly is no basis to sustain the corporate strategy”.

“It was an important factor in the *Paramount v. Time* decision, however, that the challenged merger between Time and Warner was a true share exchange merger of Time and Warner, both comparably-sized, widely-held companies in which there would have been no effective controlling shareholder of the merged entity.”

As stated above, the emergence of a “Revlon” duty in Canada would not be inconsistent with recent Canadian examples, or NP 62-202. However, the fact that a take-over bid has been made does not necessarily require target directors to solicit higher third party offers at the expense of a deliberately conceived corporate plan, or, in certain circumstances, an existing offer. For example, the court in *Schneider* held that the directors were not obliged to give another bidder, Maple Leaf, an opportunity to top the existing Smithfield bid as the evidence was that only the Smithfield offer would have been acceptable to the controlling shareholder. It should be noted that controlling shareholder(s) are a fact of life in many Canadian public companies and the reason that many public acquisitions are effected through a negotiated support (merger) agreement and plan of arrangement. Similarly, in the *WIC Western* decision, the court held that the target directors did not have an obligation to go back to CanWest before entering into the pre-acquisition agreement with Shaw. It held that this was a business and negotiating judgement call which the target directors were entitled to make.

In Canada, it is also becoming much more common for a company “put in play” to use the auction or controlled auction process – not only for value enhancement but also to provide the discipline and control inherent in such a process. This often allows a target with only

one or two bidders to control the drafting of the support (merger) agreement.

(b) The “Unocal” or “Enhanced Scrutiny” Test

The American jurisprudence concerning defensive tactics in response to unsolicited or hostile take-over bids (tender offers) revolves around the application of a test commonly known as the “Unocal test” or “enhanced scrutiny test”. This test requires directors of a target company to demonstrate that:

- (i) they had reasonable grounds for believing that a bid endangered corporate policy and effectiveness; and
- (ii) any defensive measures adopted were a reasonable response to the threat posed by the bid.

Directors in such circumstances typically discharge the first arm of the test by demonstrating that they acted on an informed basis after exercising reasonable diligence in gathering material information, acquainting themselves with the relevant facts and engaging in active deliberation before making a decision. In relation to the second arm, the courts will review all of the surrounding circumstances (including the decision-making process of the board) to determine whether the response of the directors was reasonable in the circumstances.

Although Canadian courts have not adopted the “Unocal” test, recent Canadian cases have sought guidance from the approach. For example, *820099 Ontario v. Harold E. Ballard* (1991), 3 B.L.R. (2d) 113 (Ont. Div. Ct.), which applied the “proper purpose doctrine”, suggests that one way of determining the primary purpose of the directors is to ask what was uppermost in the directors’ minds after a reasonable analysis of the circumstances. As discussed above, recent Canadian cases have taken a similar approach based on the “business judgement rule”.

(4) NP 62-202

NP 62-202 sets out the Canadian security regulators’ view on defensive tactics adopted by directors of target companies in response to take-over bids. Both NP 62-202 and its predecessor, National Policy Statement No. 38, are largely untested in reported decisions to date outside the context of shareholder rights plans or “poison pills”.

The philosophy of NP 62-202 is that:

- (a) the appropriate regulatory approach to take-over bids is to encourage unrestricted auctions;
- (b) target company shareholders have the right to make the take-over bid decision, and directors of the target have no valid reason to (unilaterally) deny the shareholders that right; and
- (c) specific rules for regulating directors of the target, other than those imposed by corporate law, are inappropriate.

NP 62-202 does not specify a fixed code of conduct for directors nor does it attempt to specify proper or improper defensive tactics. It does, however, set out some presumptions as to what may be proper or improper responses to a take-over bid, and indicates that:

- (a) prior shareholder approval might allay concerns that a tactic is abusive;
- (b) the timing of the tactic may be relevant - regulatory scrutiny may be activated when conduct occurs during the course of a bid or immediately prior to a bid if the target board has reason to believe a bid is imminent; and
- (c) certain listed defensive tactics may activate regulatory scrutiny - examples include share and asset lock-ups, asset purchases, and actions taken outside the ordinary course of business.

NP 62-202 suggests that securities regulators are less likely to intervene where directors of a target company act to maximize shareholder value. It goes further than corporate law in constraining possible conduct of directors of a target company in that directors' motivation can become irrelevant. Rather, the policy focuses on the results of the actions of the target's directors and any activity that denies or severely limits the shareholders of the target access to a take-over bid may lead securities regulators to intervene. Taking this result-oriented approach means that regulators may interfere notwithstanding director compliance with statutory fiduciary duties. For example, in *Re Tarxien Corp.* (1996), 19 O.S.C.B. 6913 (Ont. Sec. Comm.), the Ontario Securities Commission intervened and struck down a shareholder rights plan even though there was no stated evidence that the independent committee of the board was improperly motivated.

4.0 Defensive Tactics

General

As a general proposition, there are significantly less effective defences available to the boards of Canadian companies than in the U.S. and once a Canadian target company is “put in play” there is little chance that it will survive on a standalone basis.

Over the past ten years in Canada, approximately 85% of unsolicited bids have resulted in a change of control transaction and the “just say no” defence is very difficult to implement. The more typical Canadian response to an unsolicited bid is to seek a white knight and enter into a negotiated transaction in the form of a support (merger) agreement, often structured as a statutory plan of arrangement. A plan of arrangement offers a high degree of flexibility in permitting a “one-stop shop” for dealing with multiple classes of security holders, may facilitate an internal reorganization (often to achieve tax efficiency), permits arrangements with option and debt holders, as well as provide a lower threshold (usually 66 2/3%) to take a target company private. It should be noted that the compulsory acquisition of a minority interest usually requires a 90% threshold under applicable Canadian corporate law. In general terms, Canadian corporate law and securities rules and regulations, unlike U.S. law, provide decided advantages to shareholders and do not provide the directors with as much power and authority in responding to an unsolicited offer. Canadian boards must respond very quickly and must be responsive to the shareholders.

Legislative Impediments

In addition to those defensive tactics described below, the regulatory environment affecting the target company may also provide other effective means of blocking a hostile bidder. For example, there are restrictions on foreign ownership in a number of federal and provincial statutes and recent guidelines have been introduced dealing with investments by sovereign wealth funds.

Depending on the circumstances, such statutory “defenses” might also include the *Competition Act (Canada)* (which requires merger pre-notification in larger transactions, similar to *Hart-Scott-Rodino*), the *Investment Canada Act* (for a foreign acquiror in larger transactions) and possibly the Minister of Finance or other regulator for targets in regulated industries (such as banks, insurance companies, telecommunications, transportation, and oil and gas companies, to name but a few). The acquisition of the target may even introduce national security issues.

In this context, it is too early to tell whether the recent decision of the Industry Minister under the *Investment Canada Act* (“ICA”) to block the sale of a Canadian business to a U.S. buyer will have any precedent value as a potential

defensive barrier to a hostile foreign bid. In general terms, the ICA provides that unless an exemption is otherwise available (for example, on the basis that the value of the net assets of the Canadian business fall below a stipulated threshold), the acquisition of control by a non-Canadian of a Canadian business will be subject to review and the relevant Minister must be satisfied that the acquisition is of “net benefit” to Canada.

In the decision in question, a U.S. buyer agreed to buy the Information Systems Business of Macdonald Detweiler and Associates Inc. (“MDA”), which included MDA’S Radarsat 2 satellite, the “Canadarm” used in various U.S. space missions and the space robot Dextre. Following discussions between Investment Canada and the U.S. buyer, the relevant Minister refused to approve the acquisition. Interestingly MDA had been controlled by U.S. investors at the time the Radarsat agreement was entered into by the Canadian government. The deliberations under the ICA are strictly confidential and therefore the reasons for the rejection by the Minister of this acquisition are unknown. However, it is speculated that the decision was based in part on national security concerns.

It has been stated that this was the first rejection of an acquisition of control of a Canadian business (other than for cultural or heritage concerns) since the ICA was first introduced in 1985. The reality is that certain contentious transactions were either pulled from the review process prior to formal rejection or the foreign buyer negotiated appropriate written undertakings with the Crown. In fact, the rigor of the review process under the ICA has been increased over the past few years as evidenced by lengthier review periods and the scope and extent of written undertakings.

In a similar vein, the pre-merger notification process under the *Competition Act* (Canada) is alive and well and could provide an additional forum to defend against an unwanted suitor.

Stock Exchange

The relevant stock exchange and, in particular, the TSX regulate changes in the capital structure of listed issuers (Part VI of TSE Company Manual). This could be relevant for a stock option granted to the potential acquiror or a full or partial stock acquisition by such acquiror.

Change of Control Impediments

Other potential “inherent” impediments to a hostile bid would include the existence of change of control provisions in a variety of arrangements to which the target is party including material operating contracts, leases or licences, financing and credit arrangements and golden parachutes among senior management. Any of

these might make an acquisition of control prohibitively expensive and/or delay the transaction.

STRUCTURAL DEFENCES

The range of defensive tactics which will be considered include the following:

- shareholder rights plans (“poison pills”)
- other structural devices, such as charter and bylaw restrictions

Other arrangements which will be considered in this context of protecting the target company will be the following:

- standstill agreements
- reverse break fees
- go-shops
- material adverse change as a condition of closing

(1) Shareholder Rights Plans (“Poison Pills”)

Canadian shareholder rights plans or “poison pills” typically provide for the creation of rights that are issued to a target’s shareholders permitting such shareholders to acquire shares in such target at a substantial discount to the current market price or to require such target to re-purchase their shares at a substantial premium. Typically such rights cannot be exercised when originally issued but are triggered when a hostile bidder acquires a significant toehold (usually 20% on a partially diluted basis) without having obtained the consent of the target’s board. In such circumstances, the board has the right to terminate the rights plan or to exempt the bidder from the rights plan’s onerous provisions.

In addition to the TSX requirement that shareholders approve any new shareholder rights plan, an industry watchdog, the Institutional Shareholder Services, conducts a formal review process of such plans proposed by Canadian public companies and either rejects a plan or provides a “neutral” (that is, favourable) rating for the guidance of its institutional members. As a result, Canadian rights plans tend to be very uniform and relatively benign relative to U.S. rights plans. Invariably, Canadian rights plans will include the concept of a “permitted bid”, which will not shield the target indefinitely from a hostile bid. Usually a “permitted bid” is a bid made to all shareholders which remains open for, say, 60 days and which is conditional

upon acceptance by unrelated shareholders holding more than 50% of the shares not owned by the bidder (and parties related to the bidder) and can include a partial bid or a non-cash bid.

In Canada, the securities regulators have jurisdiction over rights plans when used as a defensive tactic. Such regulators have consistently held that there comes a time, usually sooner rather than later, that “the pill must go” in order to permit the shareholders of the target to respond or tender to the bid. Once again this approach is consistent with NP 62-202. Upon application of the bidder, the securities regulators will typically cease-trade the rights under the plan 45 to 75 days after a bid has been launched. While a rights plan can delay a bid in Canada, it cannot block an unwanted bid. It can, however, provide the time necessary for a board to find a white knight or another transaction which adds more value for the shareholders and other stakeholders. Often a bidder in a take-over bid will negotiate with the target as to the duration of any such shareholder rights plan.

Although a board could introduce a rights plan without shareholder approval in the face of an unsolicited bid, such action may be attacked as “oppressive” or in breach of the fiduciary duties of the directors. Canadian courts and securities regulators generally agree that it is the circumstances surrounding the use of the rights plan, rather than its introduction, that will be relevant in assessing the directors’ compliance with their fiduciary duties.

(2) Other Structural Defences

Advance Notice Bylaws

The use of charter or bylaw provisions as a defensive tactic is infrequently used in Canada. For example, the U.S. practice of having bylaws requiring shareholder proposals and board nomination to be presented to the company well before the date of the relevant shareholders meeting at which they are to be voted upon (in some instances, up to 100 days before the meeting) is unusual in Canada.

Staggered Boards

In Canada, generally directors can be removed “without cause” under federal and provincial corporate legislation at any time by a majority vote of shareholders. Thus the U.S. tactic of using staggered boards (usually with one-third of the board elected each year) as a defensive tactic to delay the replacement by a successful bidder of director nominees and thereby discourage hostile bids and proxy battles has not been used in Canada.

Attached as Exhibit "B" is an excellent comparative assessment (prepared by Chris Morgan of Skadden Arps for the Canadian Institute) of charter and by-law takeover defences available in the U.S. Some of those techniques would technically be permissible in Canada but may be resisted in many cases by the shareholders refusing to grant directors more power and authority. In addition, timing would have to be considered which could have an impact on whether the securities regulators would intercede if any changes were proposed (for example, in the face of a hostile bid) which were not for the protection of the bona fide interests of the shareholders.

Another useful summary of defensive tactics available in the U.S. is set forth in Dennis Block's terrific article "Public Company M&A: Recent Developments in Corporate Control, Protective Mechanisms and Other Deal Protection Techniques" contained in Contests for Corporate Control 2005: Current Offensive and Defensive Strategies in M&A Transactions, Practising Law Institute.

(3) Standstill Agreements

A Canadian target company, often in an auction process or other negotiated transaction, typically will request that a potential acquiror, for a limited period of time, agree not to acquire or make an offer to acquire securities of the target without the target's consent. Typically such standstill provisions - which can be contained in a separate agreement or buried in a "confidentiality" agreement or other document - fall away (a "springing provision") once a third party makes an offer for the target or a binding agreement to acquire all of the shares of the target is entered into between the third party and the target.

Two recent Ontario cases have clarified the law relating to standstill agreements. In *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust* (2007), 85 O.R. (3d) 254 (Ont. C.A.), the courts enforced a provision in an acquisition agreement requiring a target to enforce the standstill provision given in an auction process by another unsuccessful bidder, *Health Care Properties Investors Inc.* ("HCP"). In this case, HCP had agreed to a standstill provision (but without a spring) that precluded it from announcing an intention to acquire assets or shares of the target. The acquisition agreement between *Ventas* and *Sunrise* contained a "fiduciary out" provision that permitted the target to terminate the agreement for a "superior proposal" and, in addition, a covenant to enforce any existing standstill agreement.

Notwithstanding HCP's superior proposal and the "fiduciary out", the target was bound by the provisions of the acquisition agreement with *Ventas* to enforce the standstill.

In *Quebecor Media Inc. v. Osprey Media Income Fund and Black Press Ltd.* (2007), 159 A.C.W.S. (3d) 376 (Ont. S.C.J.), the target conducted an auction process in which all participants executed standstill agreements with springing provisions. *Quebecor* was the winning bidder and entered into a support agreement with the target. Subsequent to the announcement of the *Quebecor* offer, *Black Media* made a superior proposal. The case was decided primarily on its facts, but the court was influenced by the fact that the intent of the parties was that the target would be unencumbered in entering into a second round of superior bidding once the support agreement had been entered into with *Quebecor*. The court also held that the proposal made by *Black Media*, in addition to its financial and other terms, was bona fide since it did not violate the standstill agreement.

The Canadian courts, like the U.S. courts, believe that standstill agreements can serve legitimate purposes in a sale process. Such agreements ensure that confidential information of the target (usually an extremely valuable asset in any transaction) is not misused by bidders, can establish rules of the game that promote an orderly auction and give the target leverage to extract concessions from bidders.

Contrast these cases to *In Re Topps, Co. Shareholder Litigation*, 926 A.2d.58 (Delaware Chancery Court, 2007) ("*Topps*") decision in Delaware, where the board of *Topps* refused to waive a standstill in a merger agreement which contained a "fiduciary out" such that if the fiduciary duties of the board required them to do so, they could waive the standstill and accept a superior proposal. The court found that by not so waiving, *Topps* did not permit a third party to refute *Topps*' public statement that the third party was not serious in its bid and the board likely breached its Revlon duties (to maximize shareholder value) by not so waiving (thereby permitting the third party to make a tender offer for *Topps*' shares at a higher price). It should also be noted that *Topps* had not undertaken any auction or formal sale process prior to entering into the merger agreement. The court concluded that the board had not used the standstill for a proper purpose given their fiduciary duties and the circumstances.

(4) **Reverse Break Fee**

A relatively recent but still relatively uncommon provision in a support agreement is the concept of a reverse break fee (or expense reimbursement). That is, in certain circumstances when a merger agreement is terminated, the potential acquiror agrees to pay the target a stipulated amount or percentage of deal value. A reverse break fee might be required by a target where an acquiror imposes conditions on the acquisition that are specific to the

acquiror (such as approval of the acquiror's shareholders or regulatory approvals unique to the acquiror).

The reverse break fee has also been used in acquisitions by private equity investors, although once again a relatively uncommon provision – particularly because of the dramatic decline in m&a activity by private equity investors. Private equity purchasers typically require more debt financing for their acquisitions and therefore often request a condition of closing based on obtaining the required financing on terms acceptable to such private equity purchasers. In such circumstances a reverse break fee can compensate the target for a failed deal but, if properly drafted, can also serve as a limit or cap on liability of the private equity purchaser if it should walk away from the transaction. The reverse break fee in the *BCE* transaction was \$1.0 billion if, *inter alia*, *BCE* terminated the support agreement as a result of the failure of the purchaser to perform under the agreement. The break fee was \$800 million to enter into another support (merger) agreement reflecting a superior proposal.

(5) **Go-Shops**

As noted above, a typical support agreement would contain a no-shop (no solicitation) provision, subject to the board of the target being able to enter into a superior proposal if required by their fiduciary duties (the “fiduciary out”). In a sellers’ markets, a target might enter into a support agreement without having done a “market check” or market canvas provided that the agreement provided for a relatively short “go-shop” period during which the target can canvas potential bidders for a superior proposal. The initial acquiror is in effect acting as a stalking horse and will typically be paid a break fee if a superior proposal surfaces. In addition to a potential break fee, the initial acquiror has the first-mover timing advantage, can insist upon a compressed timetable for potential bidders to perform due diligence and submit an alternative proposal and often requests a right to match.

Go-shops in Canada, although still unusual, have become more sophisticated over time and include variations on the following:

- the quantum of the break fee and whether it is lower in the go-shop period
- the duration of the go-shop (usually less than 45 days)
- restrictions on the types of acquiror that can be approached (for example, only private equity or only strategic buyers)

- right to match
- whether the target is obligated to prepare and mail during the go-shop period shareholder proxy materials for the shareholders meeting to approve the transaction.

In the *Topps* case cited above, the Delaware Chancery Court rejected a claim by shareholders that the directors of *Topps* had breached their fiduciary duties (Revlon duties) by entering into a merger agreement prior to an auction or other effective market canvas, notwithstanding the 40 day go-shop provision in the agreement. The court held that the board had left itself with “reasonable room for an effective post-signing market check”.

Interestingly, very few superior proposals have surfaced in circumstances in which a go-shop provision was included and, in circumstances where go-shops are used, shareholders of the target may start to assert breach of fiduciary duty claims if the terms of such go-shops are not flexible enough – for example by providing flexibility through longer shop periods; reduced break fees for transactions entered into in the go-shop period; no restrictions on potential bidders which can be solicited; and being able to terminate the support agreement based on negotiations rather than signed support (merger) agreements.

(6) **Material Adverse Change**

It is very common in a support (merger) agreement between an acquiror and a target to provide in favour of the acquiror a condition to closing to the effect that there has been no “material adverse change” from a particular date (usually the date of signing the agreement) to the closing date. A typical definition might read as follows:

“Material Adverse Change” means any event, condition or change which materially and adversely affects **[or could reasonably be expected to materially and adversely affect]** the assets, liabilities, financial results of operations, financial conditions, business or **[prospects]** of the Company, taken as a whole”.

In recent months, principally as a result of the meltdown in the credit markets, buyers have been increasingly using the MAC clause to either walk away from transactions or use it as a threat to negotiate a reduced price. In such circumstances, target companies are becoming increasingly sensitive to the scope of a MAC clause and typically try to narrow its scope. The MAC clause is now one of the most highly-negotiated provisions in a support (merger) agreement or indeed any purchase and sale agreement and, in particular, the definition of what constitutes a MAC. The negotiations could

possibly involve defining “material” by dollar amount (usually very difficult), whether the actions are in the past or use future-oriented language (such as “could reasonably be expected to...”) and whether “prospects” are included. However, the most contentious issues are invariably the exceptions to the general MAC provision noted above.

The exceptions requested by a target could include some or all of the following non-exhaustive list:

- changes adversely affecting the general economic business or financial markets of Canada or globally (usually so long as the target is not disproportionately affected)
- changes adversely affecting the industry in which the target operates (once again, usually so long as the target is not disproportionately affected)
- the announcement or pendency of the transaction contemplated by the agreement
- the failure to meet analyst’s projections of earnings of the target
- change in laws
- changes in accounting principles
- changes to the trading price of the target’s stock related to the agreement (or unrelated)
- any breach by the buyer of the agreement
- acts of war or terrorism
- departures of key employees as a result of the announcement of the transaction
- specific disclosures set forth in a Schedule

Although there is very little Canadian jurisprudence on MAC clauses there is reason to believe that our courts would rely upon the reasoning of the Delaware courts in *Re IBP Inc., Shareholders Litigation*, 789 A. 2d 14 (Delaware Chancery Court, 2001) (“*Tyson*”) and *Frontier Oil Corporation v. Holly Corporation*, 2005 Del.Ch. LEXIS 57 (“*Holly*”). In particular Vice Chancellor Strine’s comments in *Tyson* are worth noting (p.68):

“Practical reasons lead me to conclude that a New York court would incline toward the view that a buyer ought to have to make a strong showing to invoke a Material Adverse Effect exception to its obligation to close. Merger contracts are heavily negotiated and cover a large number of specific risks explicitly. As a result, even where a Material Adverse Effect condition is as broadly written as the one in the Merger Agreement, that provision is best read as a backstop protecting the acquirer from the occurrence of unknown events that substantially threaten the overall earnings potential of the target in a durationally-significant manner. A short-term hiccup in earnings should not suffice; rather the Material Adverse Effect should be material when viewed from the long-term perspective of a reasonable acquiror.”

The courts also indicated that the parties to a merger agreement were free to negotiate MAC clauses, including the allocation of risks of foreseen and unforeseen events and to specify the party that has the burden and standard of proof for establishing the occurrence of a MAC (a target would prefer a “clear and convincing” standard to a “preponderance of evidence” standard, for example). The courts will also look to the “four corners of the agreement” in construing a MAC clause and whether, for example, another provision expressly addresses the event in question, possibly through a specific representation and warranty.

5.0 Deal Protection Measures

It has become common practice in negotiated acquisitions in Canada, as in other jurisdictions, to insist upon so-called deal protection covenants and other measures before entering into a binding support agreement to acquire a Canadian target. The underlying premise for such insistence is that such acquiror will have incurred or will incur significant time and money on financial, professional and other advisors, loan commitment fees, the costs of performing due diligence and the enormous cost of management time. In addition, and perhaps more importantly, any such potential acquiror does not normally wish to act as the proverbial “stalking house” to elicit higher bids. The range of deal protection measures in favour of potential acquirors which are common in Canada include the following:

- exclusivity or non-solicitation provisions (often referred to as “no-shop/no-talk” provisions).
- lock-up agreements with principal shareholders
- support agreements with the corporation itself (discussed above)
- break fees, termination fees and expense reimbursement

- stock and asset options (the latter sometimes referred to as “Crown-jewel” options).
- (1) Exclusivity (Non-Solicitation)**

As a quid pro quo for a potential acquiror entering into a binding support or “merger” agreement with a Canadian target in a negotiated transaction, the acquiror almost invariably insists upon exclusivity (often referred to as a “no-shop/no talk”). Such exclusivity provisions generally take the form of positive covenants on the part of the target (i) not to directly or indirectly solicit or encourage other competing offers; (ii) not to provide confidential information to any such bidders; (iii) to cease discussions and negotiations with other bidders; and (iv) to advise the acquiror of any other proposals, including the term of the proposals and the identity of the bidder.

Typical “exclusivity” or non-solicitation provisions are included as part of Exhibit “A” annexed:

Invariably, Canadian no-shops include a so-called “fiduciary out” which acknowledges the statutory fiduciary obligation of the directors of the target to consider and accept a superior proposal. The conditions upon which the Board of a target may consider and accept a superior proposal are often the subject of intense negotiation and the board’s right to accept a superior proposal may require legal and financial input, evidence of financing, certainty of completion, restricted access for due diligence etc. An acquiror-friendly clause is included as part of Exhibit “A” annexed.

(2) Right to Match

It is also very common for an acquiror under a support (merger) agreement to insist upon a relatively short period of time to match any superior proposal which the Board of the target is otherwise permitted and proposes to accept. An acquiror-friendly right to match provision is attached as part of **Exhibit “A”** annexed.

In buoyant m&a markets, a potential acquiror may wish to enter into a binding agreement as soon as possible with a target but recognizes the fiduciary obligations of the directors of the target and the fact that such board may not have had an opportunity to do a market canvas. As discussed above, in such circumstances such an acquiror may be prepared to grant the target in the merger agreement, a “go-shop” whereby for a relatively short period of time the target may actively solicit competing superior proposals. Such go-shops are often accompanied by reduced break fees payable to the “incumbent” acquiror.

(3) Force the Vote

An effective deal protection technique, but relatively uncommon in Canada, involves an obligation on the part of the target contained in the merger agreement to require the transaction with the acquiror to be submitted to the shareholders of the target irrespective of whether a superior proposal is being considered or has been announced. Such a “force the vote” covenant can be particularly effective when combined with lock-up agreements with a significant percentage of shareholders and the absence of meaningful “fiduciary-out” provisions.

(4) Break Fees

Break fees or termination fees refer to provisions in a merger agreement requiring the target to pay an amount if the transaction is terminated in specified circumstances.

The quantum of the break fee and the triggering conditions are highly negotiated. Such triggering conditions can include the entering into of an agreement reflecting a superior proposal; the failure of the transaction to close for any reason; the withdrawal of the target Board’s recommendation; acquisition of a significant toehold shareholding by a third party; and the failure of a target Board to re-affirm its recommendation following the public announcement of a competing proposal. an acquirer-friendly break fee provision is included as part of Exhibit “A” attached (note such fees are usually cross-referenced to selected termination events, such as entering into a superior proposal following payment of the “break” or “termination fee”).

Break fees in Canada typically range from 1-4% of the transactions equity value but most commonly are in the 2-3% range. The larger the transaction, generally the lower the percentage of transaction value. For example, Alcan agreed to pay Rio Tinto a break fee of C\$1.1 b (2.75% of transaction value) if, among other things, the board of Alcan recommended a competing proposal.

In competitive bidding situations, like the sale of Alcan, Dofasco and BCE, the directors of the target have to weigh the potential increase in value that can be obtained from an acquiror in return for agreeing to a higher break fee against the limiting consequence of a higher break fee.

The leading case in Canada on break fees is *WIC Western* where the court confirmed that break fees are appropriate where they are necessary to induce a competing bid to come forward, the competing bid represents a better value for shareholders of the target, and the break fee represents a reasonable

commercial balance between its possible negative impact as an action-inhibitor and its possibly positive effect as an action-stimulator.

Recently, large Canadian institutional investors have expressed a concern about the question of break fees and OMERS, one of the largest Canadian pension funds, opposes break fees in excess of 2.5% of transaction value.

In assessing the reasonableness of a termination/break fee, a recent U.S. decision, *In Re Lear Corp. Shareholder Litigation*, 926 A. 2d 94 (Delaware Chancery Court, 2007) the court observed that (at p.120):

“[f]or purposes of considering the preclusive effect of the termination fee or a rival bidder, it is arguably more important to look at the enterprise value [debt plus equity] metric because, as is the case with *Lear*, most acquisitions require the buyer to pay for the company’s equity and refinance all its debt.”

(5) Expense Reimbursement

In addition to, or sometimes in lieu of, break fees, the acquiror may be entitled to expense reimbursement in specified circumstances, such as the failure to receive regulatory approvals or required shareholder approvals.

(6) Lock-up Agreements

A potential acquiror will often require that one or more principal shareholders enter into a lock-up agreement whereby such shareholders agree to deposit or tender shares into the take-over bid or, in the case of a transaction requiring approval of shareholders by special absolution at a meeting (such as a plan of arrangement or amalgamation), agrees to vote in favour of the transaction. Unlike merger (support) agreements with the target, shareholders can contractually agree to an irrevocable lock-up as a fiduciary obligation would not normally apply.

Lock-up agreements usually take one of two forms, either a hard lock-up or a soft lock-up. A hard lock-up agreement requires the shares to be voted in favour of a transaction at the shareholders meeting called to approve the transaction, irrespective of whether, before such meeting, a superior proposal surfaces and/or the members of the Board of the target have accepted such superior proposal (in exercising their “fiduciary out”). A soft lock-up is more common and would permit release in such circumstances.

(7) Stock and Asset Options

Stock options and “crown jewel” options are not common in Canada, although the subject of the decision in the *WIC* case cited earlier involved an option to acquire a material business of WIC.

The courts appear to treat asset and stock options granted to successful bidders in a similar manner to break fees. For example in *WIC Western* the court said the grant of a “Crown jewel” option may be proper where it is done to induce a bidder to come forward provided that:

“it strikes a reasonable commercial balance between its potential negative effect as an auction inhibitor depressing shareholder value and its potential positive effect as an auction stimulator enhancing shareholder value.”

In that case the court set out a list of factors to be considered in deciding upon whether the grant of an option was either an auction-inhibitor or an auction-stimulator:

- whether the process by which the directors of the target company exercised their obligation to maximize shareholder value complied with their statutory duties as directors of the target.
- whether the overall commercial balance and proportion between the auction-inhibiting and auction-stimulating effect of such an agreement in the circumstances has been struck, that is whether the agreement is likely to preclude further bidding, in the sense of harming or significantly dampening the auction process and thus deprive the shareholders of potential additional value.
- whether the price for the optioned asset is within the range of reasonable value attributed to that asset, or whether it represents such a discount that it would result in a disproportionate erosion in the value of the corporation making it uneconomical for others to bid.
- whether the competing bid induced by the asset lock-up agreement provides enough additional value to the shareholders to justify the granting of the option.

It should also be noted that stock options granted as a deal protection mechanism could trigger stock exchange approval.

6.0 Conclusion

In the context of a change of control transaction in Canada, as a general proposition and even though the courts generally accept the business judgement rule (deference to board decisions) it is difficult to just say “no thanks” and there are fewer effective defences available to the boards of Canadian companies compared to the U.S., for example, to thwart an unwanted bidder. Similarly the range of deal protection measures is also limited in scope. This results from the fiduciary and other obligations imposed by statute on the directors, as well as the clear bias of the regulators and the courts towards the right of the shareholders to determine their own fate. In a sense it might be said that shareholder rights trump director rights in a change of control transaction.

In addition, there is a decided preference in Canada for negotiated “friendly” transactions effected by way of statutory plan of arrangement, requiring a fairness hearing and court approval. It also remains to be seen how far the courts will allow the broad oppression remedy to be used as a tool for disgruntled stakeholders in a change of control transaction.

EXHIBIT "A"
SAMPLE CLAUSES

Note: The following clauses are based on a change of control transaction effected by way of plan of arrangement contemplating shareholder approval and court orders (interim and final).

SELECTED DEFINITIONS

“**Acquisition Proposal**” means, other than the Arrangement and other than any transaction involving only the Company and/or one or more of its wholly-owned Subsidiaries, any offer, proposal or inquiry made by any Person, other than the Purchaser (or any affiliate of the Purchaser or any Person acting in concert with the Purchaser or any affiliate of the Purchaser) with respect to: (i) any take-over bid, exchange offer, plan of arrangement, merger, amalgamation, consolidation, share exchange, business combination, liquidation, dissolution or exclusive license involving the Company or any of its Subsidiaries; (ii) any acquisition or purchase (or any lease, long-term supply agreement or other arrangement having the same economic effect as a sale), direct or indirect, of all or a significant portion of the assets of, or more than **[20 percent]** of any class of the share capital, voting securities or other equity interests in the Company or any of its Subsidiaries; (iii) any other similar transactions or series of transactions involving the Company or any of its Subsidiaries;

“**Superior Proposal**” means any *bona fide* written Acquisition Proposal from a Person: (a) to acquire not less than all of the outstanding Company Shares or all or substantially all of the assets of the Company on a consolidated basis, (b) that is reasonably capable of being completed without undue delay, taking into account, all financial, legal, regulatory and other aspects of such proposal and the Person making such proposal, (c) that is not subject to any financing contingency and in respect of which adequate arrangements have been made to ensure that the required funds will be available to effect payment in full for all of the Company Shares or assets, as the case may be, (d) that did not result from or involve a breach of Section ● **[non-solicitation provision]** or Section ● **[right to match provision]** of this Agreement, (e) that is not subject to any due diligence or access condition of more than five calendar days from the date on which access is first afforded to the third party making the Acquisition Proposal, and (f) that the Board determines, in its good faith judgement, after receiving the advice of its outside legal and financial advisors, after taking into account all the terms and conditions of the Acquisition Proposal, and after taking into account at the time of determination any changes to the terms of the Agreement or the Arrangement that or of that time had been proposed by the Purchaser in writing, but without assuming away the risk of non-completion, is more favourable to Company Shareholders from a financial point of view than the Arrangement;

Section 1.0 Non-Solicitation

1. Except as otherwise provided in this Section 1.0, the Company shall not, directly or indirectly, through any of its Subsidiaries or any officer, director, employee, representative or agent of the Company or any of its Subsidiaries, (i) solicit, assist, initiate, encourage or otherwise facilitate (including by way of furnishing non-public information) any inquiries or proposals regarding, or that may reasonably be expected to relate to or lead to, an Acquisition Proposal, (ii) participate in any discussions or negotiations regarding an Acquisition Proposal, (iii) withdraw, qualify or modify (or propose to do so), in a manner adverse to the Purchaser, the approval or recommendation of the Board of this Agreement or the Arrangement, (iv) approve or recommend, or propose publicly to approve or recommend, or remain neutral with respect to any Acquisition Proposal (it being understood that publicly taking no position or a neutral position with respect to an Acquisition Proposal for no more than two Business Days after first learning of the Acquisition Proposal shall not be considered to be a violation of this Section 1.0) or (v) accept or enter into any agreement, understanding or arrangement in respect of or relating to an Acquisition Proposal; provided that nothing contained in this Section 1.0 shall prevent the Board prior to the approval by the Company Shareholders of the Shareholders Resolution from entering into an agreement with (subject to compliance with Section ● **[provision contemplating company terminating Agreement to enter into Superior Proposal and paying break fees]**) or engaging in discussions or negotiations or furnishing information to (subject to compliance with Section 1.0(2) and Section 1.0(3)) any Person who has made a written Acquisition Proposal that:

- (a) did not result from a breach of this Section 1.0; and
- (b) is a Superior Proposal (determined both at the time the Board determines to take such action and after the notice period referred to below),

so long as (x) the Board determines in good faith after consultation with its outside counsel that the failure to take such action would be inconsistent with the fiduciary duties of the members of the Board, and (y) the Company shall have provided not less than two Business Days prior written notice to the Purchaser of the intention to take such action.

2. The Company shall, and shall cause its Subsidiaries and the officers, directors, employees, representatives and agents of the Company and its Subsidiaries to, promptly terminate any existing discussions or negotiations with any parties (other than the Purchaser) with respect to any proposal that constitutes, or may reasonably be expected to constitute or lead to, an

Acquisition Proposal. Without the prior written consent of the Purchaser (which may be withheld or delayed in the Purchaser's sole and absolute discretion), the Company shall not, and shall cause its Subsidiaries not to, modify or release any third party from any existing confidentiality agreement (including, for greater certainty, any existing standstill provisions). The Company represents and warrants that it has not waived any standstill provisions contained in a confidentiality, standstill or other agreement for any Person, other than for [●]. Further, the Company shall take all action necessary to enforce each confidentiality, standstill or similar agreement which the Company or any of its Subsidiaries is a party or by which any of them is bound (in each case, other than any such agreement with [●]). The Company shall promptly request the return or destruction of all information provided to any third party which, at any time since [●], has entered into a confidentiality agreement with the Company relating to a potential Acquisition Proposal to the extent that such information has not previously been returned or destroyed, and shall use all commercially reasonable efforts to ensure that such requests are honoured in accordance with the terms of such agreements. Without limiting the foregoing, it is understood that any violation of the restrictions set forth in this Section 1.0(2) by the Company, its Subsidiaries or their respective officers, directors, employees, representatives and agents shall be deemed to be a breach of this Section 1.0(2) by the Company.

3. The Company shall immediately notify the Purchaser, at first orally and then promptly (in any event within 24 hours), of any Acquisition Proposal or inquiry or request that could reasonably be expected to relate or lead to an Acquisition Proposal, in each case received after the date hereof, of which any of its or its Subsidiaries' officers, directors, employees, representatives or agents are or become aware, or any amendments to the foregoing, or any request for non-public information relating to the Company or any of its Subsidiaries in connection with an Acquisition Proposal or for access to the properties, books or records of the Company or any of its Subsidiaries by any Person. Such notice shall include the identity of the Person making the Acquisition Proposal, inquiry or request, a description of the material terms and conditions of any such Acquisition Proposal, inquiry or request or amendment and shall include a copy of any written material received from or on behalf for such Person. The Company shall keep the Purchaser informed of any change to the material terms of any such Acquisition Proposal (as amended, if applicable), inquiry or request.
4. If the Company receives a request for material non-public information that did not result from a breach of this Section 1.0 from a Person (for greater certainty, that is not subject to an existing standstill provision) who proposes

an Acquisition Proposal and (a) the Board determines in good faith (i) after consultation with its financial advisors and its outside counsel that such proposal is a Superior Proposal and (ii) after consultation with its outside counsel that the failure to take such action would be inconsistent with the fiduciary duties of the members of the Board, and (b) the Company shall have provided not less than two Business Days prior written notice to the Purchaser of its intention to take such actions and the failure to provide such Person with access to confidential information in accordance with this Section 1.0(4) would be inconsistent with the fiduciary duties, then, and only in such case, prior to the approval by the Company Shareholders of the Shareholders Resolution, the Board may provide such Person with access to information regarding the Company, subject to the execution and delivery by such Person to the Company of a confidentiality and standstill agreement having confidentiality and other terms no less restrictive on such Person than those applicable to the Purchaser and which agreement shall not include any provision regarding an exclusive right to negotiate with the Company, provided that the Purchaser and its legal counsel shall be given a reasonable opportunity to review and comment on drafts of such confidentiality and standstill agreement prior to its execution and delivery and reasonable consideration shall be given to any comments made by the Purchaser and its counsel, and provided further that the Purchaser is promptly provided with a copy of the confidentiality and standstill agreement upon its execution and delivery, a list and copies of all information provided to such Person not previously provided to the Purchaser and is promptly provided with access to information and personnel similar to that which was provided to such Person.

Section 2.0 Right to Match

1. Subject to Section 1.0(2), the Company covenants that it will not accept, approve, recommend or enter into any agreement, understanding or arrangement in respect of a Superior Proposal (other than a confidentiality and standstill agreement permitted by Section ●) unless:
 - (a) the Company has complied with its obligations under Section ● **[dealing with non-solicitation]**, this Section 1.0 and Section ● **[dealing with notice and cure provisions]** and has provided the Purchaser with a copy of the Superior Proposal (together with a written notice from the Board regarding the value and financial terms that the Board in consultation with its financial advisors determined should be ascribed to any non-cash consideration offered under the said Superior Proposal);
 - (b) a period (the “**Response Period**”) of five Business Days shall have elapsed from the date on which the Purchaser received written notice from the Board that the Board determined, subject only to compliance with this Section 1.0, to accept, approve, recommend or enter into a binding agreement to proceed with the Superior Proposal; and
 - (c) the Company has terminated this Agreement pursuant to Section ● **[provision contemplating Company terminating Agreement to enter into Superior Proposal and paying break fee]** and shall have paid the fee prescribed by Section ● **[break fee provision]**.
2. During the Response Period, the Purchaser will have the right, but not the obligation, to propose to amend the terms of the Arrangement. During the Response Period, the Company shall negotiate in good faith with the Purchaser to make such amendments to the terms of the Arrangement as would enable the Purchaser to proceed with the transactions contemplated by this Agreement or such amended terms. The Board will review any such proposal by the Purchaser to amend the terms of the Arrangement, including an increase in, or modification of, the Consideration to be received by the Company Shareholders, in good faith in order to determine, in its discretion in the exercise of its fiduciary duties under Applicable Law, whether such proposal would, upon acceptance, result in the Acquisition Proposal previously constituting a Superior Proposal ceasing to be a Superior Proposal. If the Board determines that the Superior Proposal would cease to be a Superior Proposal, the Company will so advise the Purchaser and will accept the proposal by the Purchaser to amend the terms of the Arrangement and the Parties agree to take such actions and execute such documents as are necessary to give effect to the foregoing. If the Purchaser does not make,

within the relevant Response Period, a proposal to amend the Arrangement that would in the reasonable good faith judgement of the Board exercising its fiduciary duties under Applicable Law, cause the Acquisition Proposal previously constituting a Superior Proposal to cease being a Superior Proposal, then the Company may, subject to the terms of this Agreement, including for greater certainty Section ● **[provision contemplating Company terminating Agreement to enter into Superior Proposal and paying break fee]** and Section ● **[break fee provision]**, accept, approve, recommend or enter into any agreement, understanding or arrangement in respect of a Superior Proposal.

3. Each successive material amendment to any Acquisition Proposal that results in an increase in, or modification of, the consideration (or value of such consideration) to be received by the Company Shareholders or other material terms or conditions thereof shall constitute a new Acquisition Proposal for the purposes of this Section 1.0, and the Purchaser shall be afforded a new five full Business Day Response Period in respect of each such Acquisition Proposal.

Section 3.0 Termination

1. This Agreement may be terminated prior to the Effective Time by:
 - (a) the mutual written agreement of the Parties; or
 - (b) either the Company or the Purchaser:
 - (i) if the Shareholders Resolution shall not have been approved or adopted by the Company Shareholders at the Company Meeting in accordance with the Interim Order; **[termination relating to Shareholder rejection]** or
 - (ii) if the Interim Order and the Final Order shall have not been obtained on terms consistent with the Agreement or shall have been set aside or modified in a manner unacceptable to the Company and the Purchaser, acting reasonably, on appeal; provided that the right to terminate this Agreement pursuant to this Section 1.0(1)(b)(ii) shall not be available to any Party that has breached or failed to perform or observe the covenants and agreements of such Party set forth herein; **[termination relating to court Orders]** or
 - (iii) if any final and non-appealable Applicable Law shall be effected by a Governmental Authority of competent jurisdiction that makes the consummation of the Arrangement illegal or otherwise prohibits or enjoins the Company or the Purchaser from consummating the Arrangement; provided that the party seeking to terminate this Agreement shall have used its reasonable efforts to have such Applicable Law lifted if and to the extent required by Section ●; **[termination relating to Applicable Laws]** or
 - (iv) if the Effective Time does not occur on or prior to the Outside Date, provided that the failure of the Effective Time to so occur is not due to the failure of the Party seeking to terminate this Agreement to perform or observe the covenants and agreements of such Party set forth herein. **[termination relating to passage of time]**
 - (c) the Company:
 - (i) subject to Section ● **[notice and cure provision]**, if the Purchaser shall have breached or not performed any of its covenants set forth in this Agreement or any representation or

warranty of the Purchaser set forth in this Agreement fails to continue to be true and correct, in each case, only where the failure, breach or failure to perform would cause the conditions set forth in Section ● not to be satisfied and the Company is not then in breach of any of its representations, warranties or covenants set forth in this Agreement; or **[termination relating to Purchaser's breach]**

- (ii) prior to the approval by the Company Shareholders of the Shareholders Resolution, in order to enter into a binding written definitive agreement with respect to a Superior Proposal (other than a confidentiality agreement permitted by Section ●), in compliance with Section ● **[right to match]**, provided that the termination fee set forth in Section ● **[break fee provision]** has been paid in accordance with the terms of this Agreement. **[termination relating to Superior Proposal]**
- (d) the Purchaser:
 - (i) subject to Section ● **[notice and cure provision]**, if the Company shall have breached or not performed any of its covenants in set forth in this Agreement or any representation or warranty of the Company set forth in this Agreement fails to continue to be true and correct, in each case, only where the failure, breach or failure to perform would cause the conditions set forth in Section ● not to be satisfied and the Purchaser is not then in breach of any of its representations, warranties or covenants set forth in this Agreement; **[termination relating to Company breach]**
 - (ii) if the Board or any committee thereof shall have: (i) withdrawn or modified in a manner adverse to the Purchaser its approval or recommendation of the Arrangement (it being understood that publicly taking no position or a neutral position with respect to an Acquisition Proposal for more than two Business Days after first learning of the Acquisition Proposal shall be considered an adverse modification), (ii) approved or recommended an Acquisition Proposal or entered into a binding agreement in respect of an Acquisition Proposal (other than a confidentiality agreement permitted by Section ●) or (iii) failed to publicly recommend or reaffirm its approval of the Arrangement, after an Acquisition Proposal shall have been made to the Company Shareholders or any Person shall have publicly announced an intention to make an Acquisition

Proposal, within two Business Days of any written request by the Purchaser (or in the event that the Company Meeting is scheduled to occur within such two Business Day period, prior to the date of such meeting). **[termination relating to Board act or omission]**

2. If this Agreement is terminated in accordance with the foregoing provisions of this Section 1.0, this Agreement shall forthwith become void and of no further force or effect and no Party shall have any further obligations hereunder except as provided in Section ● **[break fee provision]**, Section ● **[fees and expenses]** and Section ● **[injunctive relief]** and the Confidentiality Agreement and as otherwise expressly contemplated hereby, and provided that neither the termination of this Agreement nor anything contained in this Section 1.0 shall relieve any Party from any liability for any wilful breach by it of this Agreement.

Section 4.0 Termination Fees

1. Notwithstanding any other provision relating to the payment of fees, including the payment of brokerage fees, if after the execution of this Agreement the transactions contemplated under this Agreement are not consummated because:
 - (a) the Purchaser shall have terminated this Agreement pursuant to Section 1.0(1)(d)(ii) **[termination relating to Board act or omission]**; or
 - (b) the Company shall have terminated this Agreement pursuant to Section 1.0(1)(c)(ii) **[termination relating to Superior Proposal]**; or
 - (c) the Purchaser shall have terminated this Agreement pursuant to Section 1.0(1)(d)(i) **[termination relating to Company breach]**; or
 - (d) the Purchaser shall have terminated this Agreement pursuant to Section 1.0(1)(b)(iv) and the reason the Effective Time did not occur prior to the Outside Date was the failure of the Company to complete the transactions contemplated hereby when required to do so; **[termination relating to passage of time]** or
 - (e) the Agreement is terminated either by the Company or the Purchaser pursuant to Section 1.0(1)(b) in circumstances where the Arrangement Resolution was not approved and adopted by the Company Shareholders at the Company Meeting in accordance with the Interim Order (as contemplated in Section ●), but only if prior to the Company Meeting an Acquisition Proposal shall have been made to the Company Shareholders or any Person shall have publicly announced an intention to make an Acquisition Proposal; provided that an Acquisition Proposal is ultimately agreed to or consummated within 12 months of the date of this Agreement. **[termination relating to Shareholder rejection]**

then the Company shall pay, or cause to be paid, to the Purchaser (or as the Purchaser may direct by notice in writing), in the case of a termination pursuant to clause (a), (c) or (d) above, within two Business Days of the first to occur of the foregoing, in the case of clause (b) above, prior to the termination of this Agreement, or in the case of clause (e) above, on or prior to the date that the Acquisition Proposal referred to in clause (e) is agreed to or consummated, in each case, an amount equal to the Purchaser's reasonably incurred out-of-pocket expenses in connection with the Arrangement in immediately available funds to an account designated by the Purchaser. The Company agrees that the payment of expenses in this Section 2.0(1) are in

addition to any damages or other payment or remedy to which the Purchaser may be entitled.

EXHIBIT "B"
ASSESSMENT OF TAKEOVER DEFENSES: CHARTER AND BYLAWS

Prepared by Christopher W. Morgan, Skadden Arps
The Canadian Institute (2006)

Assessment of Takeover Defenses: Charter and Bylaws*

Provision	What Provision Does	Where to Find Provision
Prohibition on Stockholders' Ability to Act by Written Consent**	Denies hostile raider the ability to remove and replace directors fairly quickly and without a meeting of stockholders.	Must be in Charter.
Prohibition on Ability of Stockholders to Call Special Meeting**	Confines all business to the annual meeting, limiting a Board's "window of vulnerability" to a proxy contest to one meeting per year.	Can be in either Charter or Bylaws.
Classified Board***	Makes it more difficult to get control of Board by limiting the number of directors elected in any given year (generally elect 1/3 of Board each year).	Should be in Charter.
Removal of Directors Only for Cause***	Prevents dissident stockholders from causing the removal of a director for any reason other than fraud, criminal acts, etc.	Should be in Charter; is automatically part of a Classified Board provision in Delaware.
Number of Directors Fixed Only by Board***	Prevents dissident stockholders from "packing" the Board by increasing its size.	Should be in Charter, but often in Bylaws, where it is vulnerable to amendment.
Remaining Directors have Sole Right to Fill Vacancies	Prevents dissident stockholders from "packing" the Board by filling vacant seats.	Should be in Charter, but often in Bylaws, where it is vulnerable to amendment.
Board has Explicit Authority to Amend Bylaws	Allows Board flexibility in adopting or amending Bylaw provisions.	Charter and/or Bylaws.
Supermajority Vote to Amend Certain Bylaw Provisions	Limits rights of stockholders to change a corporation's governing documents so as to facilitate a takeover.	Should be in Charter.
Prohibition on Ability to Put Forward Stockholder Proposals or to Nominate Directors at Stockholders Meeting Without Advance Notice to Company	Limits the use of "last minute" proposals and gives the Board advance notice of any dissent. Usually requires not less than 90 days' advance notice.	Usually in Bylaws.
Flexibility in Setting Annual Meeting	When coupled with other restrictions on special meetings and action by consent, grants Board flexibility to determine best time to schedule annual meeting (subject to certain Delaware law requirements).	Usually in Bylaws.
Blank Check Preferred Stock	Grants the Board authority to issue the preferred stock necessary to implement certain defenses, including a poison pill stockholder rights plan.	Must be in Charter.
Contingent Cumulative Voting	When coupled with a classified board, permits minority shareholders to further delay a hostile raider from gaining control of board of directors.	Must be in Charter.

* Chart describes Delaware law. The law of the state of incorporation of the target company governs these provisions, and provisions will vary from state law to state law.
 ** "High Vulnerability" if lacking.
 *** "Lower Vulnerability," especially if combined with a Shareholder Rights Plan.