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Securities Regulators Evaluate Private Placements as Defensive Tactics under the New Take-Over Bid Regime

By: Daniel Everall and Liam Tracey-Raymont

On October 24, 2016 the British Columbia Securities Commission ("**BCSC**") and the Ontario Securities Commission (the "**OSC**") (together, the "**Commissions**") released their joint reasons for the July 22, 2016 orders in *Re Hecla Mining*.[1]

Re Hecla Mining[2] is the first decision to assess the use of private placements as a defensive tactic since new take-over bid rules affecting National Instrument 62-103[3] ("NI 62-103") and National Instrument 62-104[4] ("NI 62-104")[5] have come into force. Its significance is heightened due to speculation that the new take-over bid regime makes previous defensive tactics, such as shareholder rights plans or poison pills, ostensibly redundant in deterring hostile take-over bids. This redundancy is primarily a result of the following mandatory requirements, which, unless subject to an exemption, cannot be waived:

- bids must remain open for a minimum period of 105 days (subject to certain exceptions);
- more than 50% of the total number of outstanding shares held by persons other than the bidder and its joint actions must be tendered under a bid before any such shares may be taken up by the bidder (the "minimum tender condition"); and
- once the minimum tender condition is satisfied, a mandatory extension of the bid must be provided for at least 10 days.

Background

Re Hecla Mining involved two applications by Hecla Mining Company ("**Hecla**") in July 2016 with the BCSC and the OSC to cease trade a private placement (the "**Private Placement**") contemplated by Dolly Varden Silver Corporation ("**Dolly Varden**"). In both applications, Hecla claimed that Dolly Varden's Private Placement – which was announced three days before Hecla commenced an unsolicited take-over bid for all of Dolly Varden's common shares (the "**Hecla Offer**") – was an abusive defensive tactic under National Policy 62-202[6] ("NP 62-202"). At the time of Hecla's applications, Dolly Varden had yet to receive TSX-V approval for the Private Placement and undertook to the BCSC not to close the Private Placement until a decision was rendered.

Hecla was an insider of Dolly Varden and held roughly 19.9% of Dolly Varden's common shares when the Hecla offer was announced. Prior to the Hecla Offer, Dolly Varden's management expressed concerns regarding the company's ability to meet certain requirements of a loan agreement between Dolly Varden, Hecla and another of Dolly Varden's shareholders (the "**Hecla Loan**"). By early 2016, Dolly Varden was pursuing ways to eliminate the Hecla Loan by offering to exchange debt for equity. After a series of communications, Dolly Varden's management concluded that Hecla would not cooperate. As the price of silver rose in April 2016, Dolly Varden was left to seek

[1] *Re Hecla Mining Company* (2016), OSC Order, online: OSC <http://www.osc.gov.on.ca/documents/en/Proceedings-RAD/rad_20160722_mining-company.pdf>; *Re Hecla Mining*, 2016 BCSECCOM 250.
[2] *Re Hecla Mining*, 2016 BCSECCOM 359; *Re Hecla Mining Company* (2016), OSCB 8927.
[3] National Instrument 62-103 – *The Early Warning System and Related Take- Over Bid and Insider Reporting Issues*.
[4] National Instrument 62-104 – *Take-Over Bids and Issuer Bids*.
[5] Amendments to NI 62-103 and NI 62-104 came into effect on May 9, 2016. In Ontario, the previous take-over bid regime was codified in Part XX of the Securities Act (Ontario) and OSC Rule 62-504 – *Take-Over Bids and Issuer Bids*, while the rest of Canada came under the purview of Multilateral Instrument 62-104. Now that Ontario has adopted what was previously a multilateral instrument, NI 62-104 has become nationally recognized.
[6] National Policy 62-202 - *Take-Over Bids – Defensive*.

alternative avenues to reduce its debt and raise capital in order to kick-start its silver operations.

On June 13, 2016, Dolly Varden entered into a loan agreement with a new lender, which provided Dolly Varden with flexibility to repay the Hecla Loan and proceed with a new equity financing in order to expand its operations. At the same time, Dolly Varden provided Hecla with formal notice of its intention to repay the outstanding balance of the Hecla Loan with funds from Dolly Varden's new lender. Dolly Varden refused Hecla's subsequent offer to amend the terms of the Hecla Loan. In response, Hecla announced its intention to proceed with the Hecla Offer on June 27, 2016, which was formally launched on July 8, 2016.

On July 5, Dolly Varden informed its shareholders that it would be proceeding with the Private Placement, with the intention of raising gross proceeds of up to $6 million.

Framework for Assessing Private Placements as a Defensive Tactic

NP 62-202 provides that a securities issuance can, in certain circumstances, constitute a defensive tactic attracting regulatory scrutiny. However, in *Re Hecla Mining*, the Commissions expressly stated that even in the face of a take-over bid, private placements can serve multiple *bona fide* corporate objectives. As a result, the Commissions acknowledged that reviewing private placements in the context of a hostile bid will be more challenging than cases involving other defensive strategies, like poison pills.

In order to balance the deference corporate law gives to boards of directors and the securities law principle of facilitating shareholder choice, the Commissions presented a two-step framework to evaluate whether a private placement constitutes an improper defensive tactic.

Is the private placement clearly not a defensive tactic?

The first step requires that the evidence in question clearly establish that the private placement is not a defensive tactic designed to alter the dynamics of a bid environment. A non-exhaustive list of considerations under this first step includes:

- whether the target has a serious and immediate need for the financing;
- whether there is evidence of a bona fide, non-defensive business strategy adopted by the target; and
- whether the private placement has been planned or modified in response to, or in anticipation of, a bid.

With regard to evidentiary onus, the Commissions explained that where an applicant is able to establish that the impact of the private placement on an existing bid environment is material, the target will have the onus of proving that the private placement was not used as a defensive tactic. In *Re Hecla Mining*, the Commissions determined that the Private Placement was material to the bid environment on account of its potential 43% dilution of Dolly Varden's common shares.

Nonetheless, after considering the evidence regarding the timing of decisions related to the Private Placement and Dolly Varden's objectives for proceeding with it, the Commissions deferred to the company's board and concluded that the Private Placement had been instituted for non-defensive purposes. The Commissions acknowledged that this finding was "relatively straight forward" due to the extensive evidentiary basis supporting the non-defensive purpose.

Does or may the private placement constitute a defensive tactic?

Though the Commissions determined pursuant to the first step that the Private Placement was clearly not a defensive tactic, the Commissions went on to articulate the second step of the framework, which may require a securities regulator to intervene where an offering does not satisfy the first test of clearly not being a defensive tactic. The second step contains a non-exhaustive list of considerations that a securities regulator may look to in determining whether to intervene an offering, including:

- would the private placement otherwise be to the benefit of the shareholders by, for example, allowing the target to continue its operations through the term of the bid or in allowing the board to engage in an auction process without unduly impairing the bid?
- to what extent does the private placement alter the pre-existing bid dynamics, for example by depriving shareholders of the ability to tender to the bid?
- are the investors in the private placement related parties to the target or is there other evidence that some or all of them will act in such a way as to enable the target's board to "just say no" to the bid or a competing bid?
- is there any information available that indicates the views of the target shareholders with respect to the take-over bid and/or the private placement?
- where a bid is underway as the private placement is being implemented, did the target's board appropriately consider the interplay between the private placement and the bid, including the effect of the resulting dilution on the bid and the need for financing?

The Commissions also noted their residual power to evaluate private placements in view of the public interest and policy considerations affecting capital markets. An emphasis was placed on the importance of the factual matrix with respect to any transactions reviewed by the Commissions.

Outcome

The Commissions found that, pursuant to the first step of the framework, the Private Placement was commenced for non-defensive business purposes. The basis for this decision included: (i) Dolly Varden's precarious financial position; (ii) the implementation of a *bona fide strategy*, which has been contemplated by the Board well before receiving the Hecla Offer; (iii) the fact that there had been no modifications to the mechanics of the contemplated Private Placement following the commencement of the Hecla Offer; (iv) Hecla knew or ought to have known that Dolly Varden was planning to raise equity on account of numerous communications between the companies to that effect; and (v) there was evidence that Dolly Varden contemplated a larger, more dilutive, private placement, but instead opted for one that was reasonable in regards to the company's needs going forward. The Commissions also saw no public interest reason to interfere with its decision.

The decision of *Re Hecla Mining* was also consistent with the recent outcome in *Re Red Eagle*[7], a case referenced by the Commissions, where the BCSC held that a private placement is not a defensive tactic if the issuer requires "some form of financing to maintain itself as a going concern."[8] Although *Re Red Eagle* was decided prior to the new take-over bid rules taking force, the BCSC was still reluctant to interfere with a private placement unless it would have resulted in a clear abuse of capital markets[9].

Conclusion

Re Hecla Mining provides that private placements can be conducted by target boards in the face of a non-solicited take-over bid. However, the Commissions, through the two-step framework, have clarified the scope in which such offerings will be permitted.

Boards of directors should consider the factors contained in the two-step framework outlined by the Commissions before deciding to proceed with a private placement in the context of an unsolicited take-over bid. However, the complexity and open-endedness of the considerations in the two-stage test indicate that securities regulators will retain significant discretion in evaluating any particular offering, and will take a nuanced, fact-specific approach when considering whether a private placement is being adopted for an improper purpose.

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[7] *Re Red Eagle*, 2015 BCSECCOM 401.
[8] Ibid at para 92.
[9] Ibid at para 89.

If you have questions regarding this article, please contact the author or any member of the Aird & Berlis LLP Corporate Finance Group:

Lawyers:

Sherri Altshuler	416.865.3081	saltshuler@airdberlis.com
Aaron S. Bains	416.865.3084	abains@airdberlis.com
Christopher F. Berrigan	416.865.3065	cberrigan@airdberlis.com
Melanie Cole	416.865.4638	mcole@airdberlis.com
Daniel Everall	416.865.4733	deverall@airdberlis.com
Thomas A. Fenton	416.865.4631	tfenton@airdberlis.com
Tony Gioia	416.865.3403	tgioia@airdberlis.com
Mat Goldstein	416.865.4637	mgoldstein@airdberlis.com
Jacqueline Goslett	416.865.4741	jgoslett@airdberlis.com
Rebecca Kacaba	416.865.7707	rkacaba@airdberlis.com
Richard M. Kimel	416.865.3961	rkimel@airdberlis.com
Martin E. Kovnats	416.865.3419	mkovnats@airdberlis.com
Matthew V. Liberatore	416.865.4639	mliberatore@airdberlis.com
Andrew Magnus	416.865.4744	amagnus@airdberlis.com
Jeffrey K. Merk	416.865.7768	jmerk@airdberlis.com
Anne E. Miatello	416.865.7717	amiatello@airdberlis.com
Margaret T. Nelligan	416.865.7710	mnelligan@airdberlis.com
Graham Topa	416.865.4739	gtopa@airdberlis.com
Liam Tracey-Raymont	416.865.3964	ltracey-raymont@airdberlis.com
Jennifer A. Wainwright	416.865.4632	jwainwright@airdberlis.com
Susan Wolburgh Jenah	416.865.4707	sjenah@airdberlis.com

AIRD & BERLIS LLP

Barristers and Solicitors

Brookfield Place
181 Bay Street, Suite 1800
Toronto, Ontario, Canada
M5J 2T9
T 416.863.1500 F 416.863.1515
www.airdberlis.com

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