

Blakes Bulletin

Mergers & Acquisitions

BCSC Releases Reasons for Decision to Cease-Trade Lions Gate Shareholder Rights Plan

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On July 26, 2010, the British Columbia Securities Commission released the full majority reasons for its April 27, 2010 decision to issue a cease-trade order in respect of Lions Gate's shareholder rights plan, which had been implemented in response to a hostile takeover bid by Carl Icahn and entities affiliated with him (the Icahn Group). The reasons elaborate on the view the Commission expressed in its previously released summary reasons that the only appropriate purpose of a shareholder rights plan is to enable a target board to seek an improved or alternative transaction. This view differs from those expressed recently by the Ontario Securities Commission in the case of *Neo Material Technologies Inc.* and the Alberta Securities Commission in the case of *Pulse Data Inc.* In those cases, the commissions declined to cease-trade rights plans that had been approved by shareholders in the face of a bid, notwithstanding that the target boards were not seeking alternative transactions.

BACKGROUND

On March 1, 2010, the Icahn Group made an offer to acquire up to 10% of the outstanding shares of Lions Gate at a price of US\$6 per share. If successful, the offer would have increased the Icahn Group's shareholdings to approximately 29.9% of the outstanding shares of Lions Gate. In response, the Lions Gate board of directors recommended that Lions Gate shareholders reject the offer, saying it was "financially inadequate and coercive and is not in the best interests of the Company". The board adopted a shareholder rights plan and set a meeting date of May 4, 2010 for shareholder approval of the plan. After adoption of the rights plan, the Icahn Group amended its offer by offering to acquire all of the outstanding

shares and setting an expiry date of April 30, 2010 for its bid. The Icahn Group subsequently increased its offer to US\$7 per share and amended the minimum tender condition of its bid to provide that the number of shares tendered under the bid, when combined with those already owned by the Icahn Group, must exceed 50.1% of the outstanding Lions Gate shares. The Icahn Group reserved the right to waive this minimum tender condition.

The Icahn Group applied to the Commission to cease-trade the Lions Gate rights plan, and on April 27, 2010, which was just a few days prior to the Lions Gate shareholders meeting to consider the rights plan, the Commission held a hearing and immediately ordered that the rights plan be cease-traded, with reasons to follow.

REASONS OF THE COMMISSION

The Public Interest and Take-Over Bid Defence Tactics

The issue before the Commission was whether it was in the public interest to order that the Lions Gate rights plan be cease-traded in light of the Icahn Group's bid.

In considering this issue, the Commission enumerated the following public interest policy principles governing the use of shareholder rights plans by target companies:

- It is in the public interest that each shareholder of a target company be given the opportunity to decide whether or not to accept or reject a bid.
- Faced with a bid, the target company board has a fiduciary duty to act in the best interests of the corporation and often takes defensive measures in discharging this duty. Regulators will be reluctant to interfere with the steps the directors are taking to discharge that duty.
- Shareholder rights plans are not contrary to the public interest when used to buy time for a target company board to respond appropriately to a bid. It follows that shareholder rights plans are acceptable only as a temporary defence. The issue is not whether a shareholder rights plan should go, but when.

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- Factors relevant to the period of time a target company will be allowed to leave a shareholder rights plan in place include:
 - potential alternatives to the bid;
 - when the shareholder rights plan was adopted and whether the shareholders approved the plan or there is otherwise broad shareholder support for it; and
 - whether the bid is coercive or unfair.
- Take-over bids are fact-specific, so the relevance and significance of the factors to be considered will vary with each case.

The Commission elaborated upon each principle and applied it to the circumstances of the Icahn Group's bid.

Shareholders' Opportunity to Decide Whether to Tender into the Bid

The Commission repeatedly emphasized the principle that shareholders must have an opportunity to decide whether or not to tender to a take-over bid. In National Policy 62-202 – *Take-Over Bids – Defensive Tactics* (NP 62-202), the Canadian Securities Administrators state that they will take appropriate action if they become aware of defensive tactics that will likely result in shareholders being deprived of the ability to respond to a take-over bid. The Commission noted that securities commissions have consistently applied these principles in their decisions. The Commission concluded that the Lions Gate rights plan, if allowed to continue, would deprive shareholders of the opportunity to respond to the Icahn bid and therefore ought to be cease-traded.

Exercise of Fiduciary Duty by the Target Company Board

The Commission noted that a target company board has a fiduciary duty to act in the best interests of the corporation. The Commission further noted that securities regulators are reluctant to interfere with actions taken by a target company board to discharge that duty; however, this reluctance is founded on the practice of target company boards making efforts to maximize shareholder value (which it described as being achieved through enhancements to the bid, competing bids, or alternative transactions) in discharging their duty. Therefore, according to the Commission, the only basis for allowing a rights plan to remain in effect is the expectation that the target company board needs a reasonable period of time to seek an improved or alternative transaction.

Based on this reasoning, the Commission found that, in the absence of any attempts by the Lions Gate board to take any steps to increase shareholder value through an improvement of the bid or the presentation of alternative transactions, there was no basis for allowing the rights plan to continue and that the plan should be cease-traded on that basis alone. The Commission concluded that, at the time of the hearing, the plan had accomplished all that it was likely capable of accomplishing and therefore the Commission found it to be in the public interest to cease-trade the plan.

Although the Commission discussed the decisions of the Alberta Securities Commission in *Pulse Data Inc.* and of the Ontario Securities Commission in *Neo Material Technologies Inc.* in this context, it did not comment on the view expressed by the Ontario Securities Commission in *Neo* that the pursuit of value-enhancing alternative transactions is not the *only* legitimate purpose of a shareholder rights plan, and that a rights plan may be adopted for the broader purpose of protecting the long-term interests of shareholders. Moreover, the Commission did not consider the Supreme Court of Canada decision in *BCE Inc.*, which the Ontario Securities Commission relied on in *Neo* and was handed down subsequent to many of the decisions relied upon by the Commission in its reasons. In *BCE*, the Supreme Court of Canada made it clear that the fiduciary duty is owed to the corporation, and not the stakeholders, and is not confined to a consideration of short-term profit or share value, but rather, where the corporation is a going concern, to the long-term interests of the corporation.

A Shareholder Rights Plan is only a Temporary Defence

The Commission found that it is implicit in NP 62-202 that shareholder rights plans can stay in place only as a temporary measure, because a plan left permanently in place would deprive shareholders of the ability to respond to a take-over bid.

In addition, the Commission found that the various securities commissions in Canada have consistently taken the view that, when considering an application to cease-trade a rights plan, the issue is not whether the rights plan must go, but when. The Commission described the central issue as being whether there is a real and substantial possibility of the board's producing a better transaction for the shareholders to assess. In previous decisions where a commission decided that it

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was time for the shareholder rights plan to go, it was because the plan had achieved its purpose (by generating an enhancement to the original bid, a competing bid, or an alternative transaction) and was unlikely to achieve more, or because there was no evidence that the plan's continuation would result in any of those things. In the decisions where a commission decided it was not time for the shareholder rights plan to go, it was because the plan had not yet yielded these results, and it was too soon to conclude that its continuation would not be successful in doing so.

The Commission explicitly declined to interpret the *Pulse Data* and *Neo* decisions as authorities for the proposition that a target company board can enshrine a shareholder rights plan and "just say no" to offers not permitted under the plan, if the company's shareholders have approved the plan in the face of a bid. The Commission found that the *Pulse Data* and *Neo* decisions do not represent any significant change to the Canadian securities regulators' public interest policy principles governing shareholder rights plans. The Commission relied on the fact that, in both decisions, the commissions indicated that a change in circumstances could lead to the shareholder rights plan being cease-traded. It went on to note, however, that it was unfortunate that the panels in those cases did not provide guidance about the type of changes in circumstances which could lead to that result, and that, in the Commission's view, the usefulness of those decisions as authorities is limited as a result.

Shareholder Approval or Support of a Shareholder Rights Plan

The Commission also considered the significance of shareholder approval of shareholder rights plans, stating that shareholder approval is a relevant, but not determinative, factor in deciding whether it is in the best interests of shareholders that a plan remain in effect. The Commission again criticized the decision in *Pulse Data*, noting that the Alberta Securities Commission appears to have treated the target's shareholder approval as determinative in upholding the plan in that case. The Commission observed that the result in *Pulse Data* was to allow a minority of the target's shareholders to determine the outcome of a bid, which it found was "inconsistent with the principle that the shareholders ultimately have the opportunity to decide

whether or not to tender into the bid." The Commission noted that, similarly, in *Neo*, even though a significant majority of the target's shareholders had approved the rights plan, the remaining one-third of shareholders had been deprived of the opportunity to tender to the bid. The Commission's view on the significance of shareholder approval appears to reflect a view that one of the principles governing the use of shareholder rights plans is that *each* shareholder of a target company must be given the opportunity to decide whether or not to accept or reject a bid.

The Lions Gate rights plan was scheduled to be considered by shareholders within a few days of the hearing, and the Commission noted that Lions Gate had urged the Commission to delay considering cease-trading the plan until after the shareholders meeting. However, in the Commission's view, possible forthcoming shareholder approval was not relevant, as there was no basis for allowing the plan to continue if the Lions Gate board was not actively seeking alternatives to the bid.

Coerciveness or Unfairness

The Commission cited a number of decisions to demonstrate that where coercion is found, it is a factor in determining whether to allow the shareholder rights plan to continue while the target's board seeks alternatives. However, the Commission concluded that this does not change the basis for extending the shareholder rights plan—that the board needs time to seek alternatives—nor does it change the criteria for determining when a shareholder rights plan must come to an end.

Lions Gate took the position that the Icahn Group's bid was coercive, because a shareholder could not know how much of the company would end up in the Icahn Group's hands and would therefore not have the information necessary to make an informed decision as to whether to tender to the bid. The Commission disagreed and concluded that the bid was not coercive. It noted that the Icahn Group's bid had been revised to include a provision whereby, if the minimum tender condition was satisfied, the bid would be extended for 10 days so that those who rejected the offer could have the opportunity to tender their shares. If the Icahn Group waived the minimum tender condition, there

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would similarly be a 10-day extension during which those shareholders who had not tendered could reconsider their decision, and those who had tendered would have a right to withdraw.

SUBSEQUENT DEVELOPMENTS

Following the decision of the Commission (and the subsequent dismissal by the British Columbia Court of Appeal of an appeal of the decision by Lions Gate), and notwithstanding that the Lions Gate rights plan remained subject to a cease-trade order, Lions Gate proceeded with its shareholders' meeting to consider the plan on May 12, 2010. Turnout at the shareholders' meeting was high, with holders of 90.9% of Lions Gate shares casting votes at the meeting. Of the votes cast, 55.7% were in favour of the plan, while 44.3% were against. Excluding the votes submitted by the Icahn Group, 70.4% of votes were in favour of the plan, while 29.6% were against.

On June 17, 2010, after further extending its bid and eliminating the 50.1% minimum tender condition, the Icahn Group announced that it would take up approximately 13% of Lions Gate's outstanding common shares, which increased its ownership to approximately 31% of the outstanding Lions Gate shares. The Icahn Group then announced one further extension and, on June 30, 2010, announced that it had taken up additional shares of Lions Gate, bringing its ownership to approximately 33.9% of the outstanding Lions Gate shares, which is sufficient to give the Icahn Group veto power over certain fundamental transactions such as amalgamations or significant asset sales.

On July 20, 2010, the Icahn Group announced a new bid to acquire the remaining shares of Lions Gate at a lower price of US\$6.50 per share. On the same day, Lions Gate announced that it had completed a deleveraging transaction to convert US\$100-million of debt to equity, bringing its number of outstanding shares from 119 million to 135 million, effectively reducing the Icahn Group's stake in Lions Gate. The bid is ongoing and the Icahn Group has brought an action in both New York and British Columbia courts claiming, among other things, that the deleveraging transaction is oppressive and should be set aside.

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