ALBERTA SECURITIES COMMISSION PROVIDES GUIDANCE ON SHAREHOLDER RIGHTS PLANS, BREAK FEES AND USE OF EQUITY SWAPS IN TAKE-OVER BID CONTEXT

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Introduction

On December 21, 2021, in *Re Bison Acquisition Corp*, 2021 ABASC 188, a panel of the Alberta Securities Commission ("**ASC**") issued its written decision (the "**Decision**") providing its reasons for the oral ruling it made on July 12, 2021 regarding applications brought by Bison Acquisition Corp ("**Bison**") and Brookfield Infrastructure Corporation Exchange Limited Partnership ("**BICELP**"), Inter Pipeline Ltd. ("**IPL**") and Pembina Pipeline Corporation ("**Pembina**"). Bison and BICELP are two of the several entities referred to in the Decision that are connected to Brookfield Asset Management Inc.; all of those connected entities are collectively referred to as "**Brookfield**".

The applications related to competing proposals to acquire IPL by Brookfield and Pembina. With a view to protecting the market and the integrity of IPL shareholders' choice between Brookfield's and Pembina's competing proposals for IPL, the ASC dismissed Brookfield's application and issued a number of orders in the public interest.

The Decision indicates that (i) there still can be value to "tactical" shareholder rights plans (those adopted in the face of a hostile bid), albeit in limited circumstances, (ii) properly structured "break fees" (fees paid upon a termination of a deal) are not abusive and (iii) the use of equity swaps and other similar derivative arrangements by a bidder in the context of a hostile take-over bid could be found to be abusive and care should be taken in utilizing such instruments in that context.

Background

Key points that led to the filing of the applications:

- In February 2021, Brookfield made an unsolicited take-over bid for IPL. At this time, Brookfield announced that it beneficially owned and exercised control and direction over approximately 9.75% of the common shares of IPL ("**IPL Shares**") and also had economic exposure to an additional 9.9% of the IPL Shares (the

"**Swap Shares**") through certain cash-settled total return swaps ("**IPL Swaps**") referencing IPL Shares. The February offer stated that Brookfield had no "right to vote, or direct or influence the voting, acquisition, or disposition of" any Swap Shares held by the swap dealer, and that "no person acting jointly or in concert with [Bison] beneficially owns or exercises control or direction over any securities of IPL."

- Brookfield had not filed any early warning report as it did not have beneficial ownership, or control or direction over, 10% or more of the IPL Shares.
- The swap counterparty was not publicly identified in Brookfield's offer or supporting documents. The counterparty was the Bank of Montreal and Brookfield had a series of relationships with the Bank of Montreal and its affiliates, including having engaged BMO Nesbitt Burns Inc. ("**BMO NB**") as its financial advisor for the possible acquisition of IPL, which engagement provided for a $15 million completion fee payable on Brookfield's acquisition of IPL (the "**BMO Completion Fee**"). [1] The term "**BMO**" is used to refer to various Bank of Montreal entities, including Bank of Montreal, BMO NB and BMO Capital Markets.
- In February 2021, a special committee (the "**Special Committee**") of the board of directors of IPL (the "**IPL Board**") was formed to undertake a strategic review of IPL's options (the "**Strategic Review**") and to assist in responding to Brookfield's offer.
- On March 31, 2021, the IPL Board adopted a supplemental shareholder rights plan (the "**Supplemental SRP**"), which amended certain provisions in IPL's May 8, 2017 shareholder rights plan, as reconfirmed by IPL shareholders on May 7, 2020. The main change was to amend the definition of beneficial ownership to include certain derivative transactions for the purposes of the 20% triggering threshold, which would have the effect of including the Swap Shares in the calculations of Brookfield's beneficial ownership of IPL Shares, and effectively prevent Brookfield from acquiring any additional IPL Shares or IPL Swaps outside of its take-over bid.
- On May 31, 2021, Pembina and IPL entered into an arrangement agreement (the "**Pembina Arrangement**"), which included a negotiated reciprocal $350 million break fee (the "**Break Fee**").
- Brookfield made subsequent offers by news release on each of June 4, 2021 and June 21, 2021 (together with the February offer, the "**Brookfield Offer**"). In its June 4, 2021 press release, it defined its 19.65% economic interest in IPL as the "Brookfield Block", which it noted would create "a substantial and protracted overhang on [the Pembina Shares]", should the Pembina Arrangement succeed.
- On June 25, 2021, the IPL Board amended the Supplemental SRP so that it expired the day after the IPL shareholder vote on the Pembina Arrangement.

The Applications

Brookfield

Brookfield applied for orders under ss. 179 and 198 of the Securities Act (Alberta) (the "**Act**") in connection with

what it characterized as inappropriate defensive tactics taken by the IPL Board in response to the Brookfield Offer, namely adopting the Supplemental SRP and agreeing to pay Pembina the $350 million Break Fee (the "**Brookfield Application**").

The relief sought by Brookfield included an order cease trading the Supplemental SRP, an order restraining IPL from paying the Break Fee to Pembina, and an order that all trading cease in respect of any securities that were proposed to be issued or exchanged in connection with the Pembina Arrangement.

IPL and Pembina

In its June 18, 2021 cross-application (the "**IPL Application**"), IPL asserted that Brookfield's conduct in connection with the IPL Swaps was abusive of IPL shareholders and the capital markets on the following four grounds: using IPL Swaps to avoid early warning reporting ("**EWR**") obligations under National Instrument 62-104 *Take-Over Bids and Issuer Bids* ("**NI 62-104**"); failing to make proper public disclosure regarding the IPL Swaps, including as required under NI 62-104; using the IPL Swaps "held by a captive and compliant [swap] counterparty … to try to defeat shareholder approval of the Pembina Arrangement"; and using the IPL Swaps to try to meet the minimum tender condition of over 50% under the Brookfield Offer.

The relief sought by IPL under ss. 179 and 198 of the Act in relation to the IPL Swaps included orders:

- directing Brookfield to issue a notice of change to the Brookfield Offer and providing additional public disclosure relating to the IPL Swaps (the "**Proposed Disclosure Order**");
- directing that the Swap Shares be considered beneficially owned or controlled by Brookfield or a person acting jointly or in concert with Brookfield (and therefore excluding the Swap Shares from the minimum tender condition amount) (the "**Proposed Minimum Tender Order**"); and
- deeming the Swap Shares to be voted at the IPL shareholders meeting regarding the Pembina Arrangement (the "**IPL Shareholders Meeting**") in the same proportions for or against the Pembina Arrangement as all other non-Brookfield-owned or controlled IPL Shares, or preventing the Swap Shares from being voted regarding the Pembina Arrangement (the "**Proposed Voting Order**").

Pembina adopted the IPL Application and also sought an additional order under s. 198 of the Act cease trading any securities proposed to be issued or exchanged in connection with the Brookfield Offer, including the proposed transfer of IPL Shares pursuant to the Brookfield Offer (the "**Proposed Brookfield Offer CTO**").

The Shareholder Rights Plan

Historically, the principal rationale for justifying a shareholder rights plan in the face of a hostile take-over bid was that it permitted the target board time to seek an alternative transaction. With the 2016 amendments to NI 62-104 which, among other matters, lengthened the time a bid must be open from 35 days to 105 days, this

justification for shareholder rights plans is no longer significant. However, the ASC noted that a plan that furthers the objectives of the take-over bid regime may be entirely appropriate, depending on the circumstances of the case.[2]

Brookfield contended that the Supplemental SRP unduly and unfairly interfered with the rights of IPL shareholders, including Brookfield as a shareholder by denying it its right to acquire an additional 5% of IPL Shares during the course of the bid pursuant to statutory exemption, and frustrated the take-over bid process. It also emphasized the fact that the IPL Board did not seek or obtain shareholder approval of the Supplemental SRP.

The ASC disagreed with Brookfield's arguments and dismissed the part of the Brookfield Application relating to the Supplemental SRP. Of note, the panel found that:

- the IPL Board acted reasonably in adopting the Supplemental SRP given (i) legitimate concerns raised by the size and nature of Brookfield's interest in IPL, including the effect such interest would have on the willingness of other prospective bidders to participate in an auction, the willingness of shareholders to make the effort to vote on a competing transaction, and the outcome of any shareholder vote and (ii) its assessment that the Swap Shares had the potential to unfairly distort the outcome of the vote whether they were voted against an alternative transaction or not voted at all (as discussed further below);
- the Supplemental SRP did not prejudice IPL shareholders but rather prevented Brookfield from accumulating a negative control position that could have hindered a genuine shareholder preference for the Pembina Arrangement or any other alternate transaction;
- while the Supplemental SRP would be in place until after the vote on the Pembina Arrangement (approximately 4 months), there is no rule regarding timing, and this time was needed to uphold the Supplemental SRP's purpose;
- the interests of the IPL shareholders, other than Brookfield, to obtain the highest price for their shares take precedence over Brookfield's rights as a bidder (although also a shareholder) to acquire IPL Shares as cheaply as possible; and
- shareholder approval of a plan is not necessarily determinative and, in this case, the vote on the Pembina Arrangement served as a proxy.

The Break Fee

It was generally agreed by all parties that break fees are not improper or unusual in M&A transactions, but that the amount of the fee can lead to a challenge as an improper defensive tactic. In *CW Shareholdings (Ont. Gen. Div.)*, the Ontario Court accepted that a break free is appropriate where (i) it is needed to induce a competing bid; (ii) the bid represents better value for shareholders; and (iii) the fee reflects "a reasonable commercial

balance between its potential negative effect as an auction inhibitor and its potential positive effect as an auction stimulator" (the "**CW Shareholdings Test**"). Brookfield argued that the Break Fee did not meet the CW Shareholdings Test and was an improper defensive tactic that was contrary to the best interests of IPL shareholders.

However, in this case, the ASC was satisfied that the Break Fee met each element of the CW Shareholdings Test. Based on evidence submitted, it found that Pembina would not have made a competing bid without the Break Fee, because, in addition to the usual reasons for seeking a break fee[3], Pembina faced a greater possibility of a failed transaction due to Brookfield's significant toehold position in IPL and further risks due to disclosure of confidential information to IPL, a competitor in the same industry.

In response to Brookfield's argument that the Pembina offer did not represent better value for shareholders than the Brookfield Offer, the ASC stated that the evidence included detailed information about the IPL Board's assessment of the value of a transaction with Pembina, and the reasons why it had concluded that the Pembina Arrangement was preferable. The panel noted that the choice of the IPL Board to endorse the Pembina transaction, based on the results of the Strategic Review and the advice of its professional advisors, was a reasonable exercise of its business judgment and should be given deference.

With respect to quantum, the ASC noted that the determination of the amount is highly fact-specific with no fixed minimum or maximum break fee. In the circumstances, the ASC found that the Break Fee, at 2.3% of IPL's enterprise value, was below average and well within precedent ranges, and at 4.2% of equity value, while at the higher end of precedent ranges, was still within reason because of the risks Pembina faced in pursuing a transaction with IPL. Additionally, the panel agreed with IPL's submission that enterprise value was the better measure as IPL was highly leveraged and in the same industry as Pembina.

A remedy requested by Brookfield was for the ASC to either reduce or eliminate the Break Fee. The ASC determined that it did not have this jurisdiction and that the only possible remedy would be a cease-trade order under the ASC's "public interest" jurisdiction, if warranted. However, as the ASC did not find the Break Fee to be an improper defensive tactic, it dismissed the part of the Brookfield Application relating to the Break Fee.

The IPL Swaps

The ASC identified two separate issues relevant to the IPL Swaps, namely (i) whether in order to avoid contravening the EWR requirements Brookfield was required to disclose its combination of a 9.75% beneficial ownership interest and additional 9.9% economic interest, and (ii) whether Brookfield's use of the IPL Swaps was clearly abusive of investors and the capital market.

Hidden Ownership and Empty Voting

The panel considered the history of amendments and proposed amendments to the take-over bid regime relevant to the IPL Swap issues, in particular those relating to "hidden ownership" and "empty voting". In 2013, the Canadian Securities Administrator ("**CSA**") proposed to include certain types of derivatives that affect an investor's total economic interest in an issuer (which would include the IPL Swaps) for the purposes of determining the early warning reporting threshold trigger. The rationale behind this proposal was to ensure proper transparency of securities ownership, and specifically to avoid the use, by sophisticated investors, of equity swaps or similar derivative arrangements that result in (i) the accumulation of a substantial economic interest in an issuer without public disclosure, followed by conversion of this interest into voting securities in time to exercise a vote (referred to as "hidden ownership"), and (ii) the holding of substantial voting rights in an issuer and possibility of influencing the outcome of a shareholder vote without having an equivalent economic stake in the issuer (referred to as "empty voting"). In 2016, after numerous comments received against the proposal on various grounds, and there being no clear evidence of abuse, the CSA did not proceed with the proposal.

The ASC also looked at *Re Sears Canada Inc.*[4] and noted that while the *Sears* decision found that the use of swaps in that case was not abusive, the decision nonetheless included the following statement: "We wish to underscore that there might well be situations, in the context of a take-over bid, where the use of swaps to "park securities" in a deliberate effort to avoid reporting obligations under the [Ontario Act] and for the purpose of affecting an outstanding offer could constitute abusive conduct sufficient to engage the [OSC's] public interest jurisdiction."

EWR Disclosure

With respect to the EWR requirements, the ASC confirmed that swaps are not generally required to be included when determining whether the 10% threshold had been met. Per National Policy 62-203 *Take-Over Bids and Issuer Bids*, a swap investor may be deemed to have beneficial ownership, or control or direction, over the referenced securities as a result of the ability to obtain such securities or to direct the voting of them. The panel was satisfied that Brookfield did not have either the legal right to control or direct the voting of Swap Shares held by BMO or a contractual right to influence BMO's voting decisions for the Swap Shares.

General Disclosure of IPL Swaps

In assessing the assertion that Brookfield made inadequate disclosure of the IPL Swaps in the Brookfield Offer and other documents, the panel considered the disclosure requirements set out in NI 62-104 and Form 62-104F1, including the requirement to provide "any material facts concerning the securities of the offeree issuer". Material was assessed as whether there was a substantial likelihood that the omitted facts would have been important or useful to a reasonable prospective investor in deciding whether to tender the IPL Shares at

the price offered.

The panel considered evidence presented relating to possible harms to IPL shareholders and the capital market stemming from Brookfield's lack of disclosure, including (i) some prospective buyers having declined to consider bidding on IPL because they had the impression Brookfield "effectively already had control or had "won'", (ii) various media reports describing Brookfield as owning, or having a stake of, almost 20% in IPL, without mentioning that 9.9% of that was an economic interest with no voting rights, and (iii) prospective buyers, IPL shareholders, or media not knowing that Brookfield had an extensive pre-existing relationship with its swap dealer, including that BMO NB was to receive the BMO Completion Fee if the Brookfield Offer was to succeed, which could influence BMO's voting of the Swap Shares.

On analysis of Brookfield's public disclosure relating to the extent of its ownership of the IPL Shares, the panel determined that the following details regarding the IPL Swaps and Brookfield's relationship with BMO were material:

- Brookfield only had a 9.75% voting interest in IPL
    - In February 22, 2021 and June 4, 2021 letters to IPL shareholders, Brookfield only disclosed the 19.65% economic interest, which the panel felt could have led IPL shareholders to perceive the Brookfield Offer as having a greater chance of success than its actual voting interest implies;
    - In a June 4, 2021 news release, Brookfield used the term "Brookfield Block" in relation to the 19.65 % economic interest which the panel felt implied that Brookfield could use this full interest to block the Pembina Arrangement; and
- Brookfield's relationship with BMO and the potential conflicts of interest that the relationship creates, particularly since Brookfield knew that its relationship with BMO could lead BMO to tender or vote the Swap Shares in a way favourable to Brookfield.

Given that the above were determined to be material, by not disclosing, the ASC concluded that Brookfield had failed to comply with the requirements of NI 62-104.

Clearly Abusive?

The panel concluded that it was not necessary for it to decide whether the "animating principles standard" (i.e. whether the ASC can intervene in the public interest on a broader basis where the letter of the applicable securities law, policy, or rule has been complied with, but the "animating principles" or spirit underlying those rules have not) applied in Alberta in general, or applied in the case before it, as it was satisfied that Brookfield's behaviour was "clearly abusive".

EWR Threshold

In considering Brookfield's conduct, the panel referenced "Brookfield's size, complexity and sophistication". The ASC was satisfied that Brookfield or its advisors would have been aware of the 2013 bid regime proposals and related policy discussions and the *Sears* comment that the use of swaps could constitute abusive conduct (both discussed above). The panel concluded that the circumstances in this case are evidence of exactly the type of abuse about which the CSA had voiced concerns.

The panel concluded that Brookfield was able to keep the IPL Share price supressed until it made the Brookfield Offer and succeeded in limiting the alternatives IPL could pursue during the Strategic Review, which could have negatively affected the ability of IPL to find the maximum value available for shareholders.

Therefore, and in spite of Brookfield's compliance with the EWR requirements, the ASC found that Brookfield's use of IPL Swaps to gain a 19.65% economic interest in IPL without making any disclosure until the Brookfield Offer was clearly abusive of IPL shareholders and of the Alberta capital market.

Brookfield's Disclosure Generally

As noted above, the panel found that Brookfield's disclosure did not meet the requirements of NI 62-104. In addition, the ASC found that Brookfield did not correct obvious misapprehensions among the media and capital market participants. Further, the ASC found a conflict of interest with the BMO relationships and that the seriousness of this conflict was exacerbated when Brookfield failed to make disclosure of BMO's multiple roles.

Brookfield's use of the IPL Swaps was found to be "an attempt to gain an insurmountable advantage in its quest to acquire IPL", which could negatively impact the auction process, and the effect was compounded by Brookfield's disclosure issues.

The ASC also determined that the omitted disclosure would have been important or useful to other parties potentially interested in competing with Brookfield and Pembina for control of IPL, and that such potential participants should have been provided with all relevant information necessary to allow them to participate in a fair and even-handed process.

The panel concluded that Brookfield's behaviour was clearly abusive of the capital market and of IPL shareholders whose interests are intended to be protected by the take-over bid regime.

Remedies for Disclosure Contraventions and Clearly Abusive Behaviour

Proposed Voting Order

With respect to the Proposed Voting Order[5], the ASC concluded it lacked the jurisdiction to make the Proposed Voting Order.

Proposed Brookfield Offer CTO

Regarding the Proposed Brookfield Offer CTO, despite have the jurisdiction to do so, the panel declined to cease trade the Brookfield Offer as it would deny IPL shareholders the ability to decide for themselves whether to tender to the Brookfield Offer.

Proposed Disclosure Order

In considering the Proposed Disclosure Order, the panel emphasized the role of disclosure as a cornerstone of securities regulation. It observed that the greatest negative consequence of Brookfield's conduct was the IPL shareholders' loss of the opportunity to make a fully informed decision, and found that the most appropriate mitigating measure would be an order requiring Brookfield to make proper disclosure of specified material facts[6] and allowing sufficient time for dissemination of that disclosure.

Proposed Minimum Tender Order

The panel determined that it would be unfair to other public IPL shareholders to allow the Swap Shares to be included in the minimum tender condition given (i) the separation of economic interest from their tendering rights and voting rights, and (ii) the effect of BMO's extensive commercial relationship with Brookfield on how the Swap Shares were dealt with. The panel considered that the public interest called for the protection of IPL shareholders (other than Brookfield and BMO) through modification of the statutory minimum tender condition to neutralize the effect of all of the Swap Shares being tendered to the Brookfield Offer. Accordingly, the ASC ordered that the minimum tender condition be adjusted from the statutorily required greater than 50% of the issued and outstanding IPL Shares not owned by Brookfield to 55% of those shares.

Conclusion

This decision highlights the importance of understanding the rights and obligations of both the bidder and a target in a take-over bid situation. Any member of McMillan's Capital Markets & Securities Group would be please to discuss the Canadian take-over bid regime with you.

[1] The other relationships included BMO's shareholdings in various Brookfield entities, BMO's lending activities with Brookfield, and BMO's securities-related activities with Brookfield (including recent underwriting and investment banking).
[2] The objectives of the take-over bid regime are set out in National Policy 62-202 *Take-Over Bids – Defensive Tactics* ("**NP 62-202**"), being the protection of the bona fide interests of the shareholders of the target company, and the provision of a regulatory framework within which take-over bids may proceed in an open and even-handed environment.
[3] Compensation for time and resources expended, opportunity costs, and the risk to a bidder's reputation and

share price.

[4] (2006), 35 O.S.C.B. 8781. *Sears* involved a take-private transaction where one shareholder, through investment funds, had a 11.6% economic interest in the target comprised of 5.2% of the outstanding shares and a 6.4% economic interest through swaps, and faced the allegation that the swaps had been used to retain control or direction over the issuer's shares and to "park" the shares so they would not be voted in the minority approval of the take-private transaction.

[5] The proposal was to permit the Swap Shares to be voted in the same proportion for or against the Pembina Arrangement as all other IPL Shares voted at the IPL Shareholders Meeting except Brookfield's.

[6] The ASC ordered disclosure of the following: the name of the swap counterparty (BMO); the dates of the Swap Agreements between Brookfield and BMO; the dates of the transactions pursuant to which Brookfield acquired an economic interest in IPL Shares with respect to the IPL Swaps; certain material information concerning Brookfield's commercial relationship with BMO; and the existence of, amount of, and conditions for the payment of the BMO Completion Fee.

by Paul Davis, Cynthia Sargeant, and Andjela Sabet

A Cautionary Note