AUGUSTA DECISION—THE BRITISH COLUMBIA SECURITIES COMMISSION HOLDS THAT THE RIGHT OF A SHAREHOLDER TO TENDER TO A BID REMAINS PARAMOUNT

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IntroductionOn May 2, 2014, the British Columbia Securities Commission (the "**BCSC**") issued an oral decision allowing the shareholder rights plan (the "**Plan**") of Augusta Resource Corporation ("**Augusta**"), which had been overwhelmingly approved by the shareholders of Augusta at a meeting held on such date, to remain in place until at least July 15, 2014—156 days from the announcement of the hostile take-over bid for Augusta (the "**Bid**") made by HudBay Minerals Inc. ("**HudBay**"). Pursuant to the decision, the Plan would be cease-traded on July 15, 2014 if the Bid was extended by HudBay to at least July 16, 2014 and a further 10-day extension of the Bid was provided to shareholders if any shares were taken up under the Bid. [1]

On June 27, 2014, the BCSC publicly released the much-anticipated reasons for this decision. [2] The BCSC noted that the key issue before it was the balancing of interests between the right of each shareholder to accept a take-over bid and the right of the shareholders as a group to determine that a rights plan ("**SRP**") should stay in place for the benefit of the issuer. Ultimately, the BCSC followed its prior reasoning in the majority decision in *Icahn Partners LP v Lions Gate Entertainment Corp* [3] and appears to have confirmed that, at least in British Columbia, the right of individual shareholders to tender to a bid remains paramount.

Legal Landscape Prior to Augusta decision

The interpretation and application of National Policy 62-202 *Take-Over Bids — Defensive Tactics* ("**NP 62-202**"), the policy under which securities regulators consider unsolicited take-over bids and the defensive tactics employed by target boards, has produced inconsistent results across the country and had introduced a level of uncertainty to market participants as to the likely outcome of SRP hearings, particularly in those cases where shareholder approval of an SRP had been obtained in the face of a specific bid. The inconsistent results reflect the differing approaches of securities regulators with respect to the purpose of SRPs, the manner in which they can be used, and the resulting length of time for which an SRP may be allowed to stand. Essentially, two lines of thought have emerged:

1. the only legitimate purpose of an SRP is to allow a target board to seek an improved or alternative offer,

as each shareholder has an absolute right to accept or reject a bid (represented initially by the decision of the Ontario Securities Commission ("**OSC**") in *Canadian Jorex Ltd, Re* [4] and more recently by the majority decision of the BCSC in *Icahn*). As a result, Canadian securities regulators have typically been willing to cease-trade SRPs of target companies within 45 to 60 days following the launch of a hostile bid, thereby ensuring that shareholders have the right to tender to a bid. The customary effect of this approach is that the target company is forced into a process which, depending on the time available to the target prior to expiry of the initial bid as well as market and specific industry conditions, usually results in its sale by auction; and

2. an SRP may be adopted for broader longer-term purposes when approved by an "overwhelming" majority of informed shareholders in the face of a specific bid (represented by the decisions of the OSC in *Neo Material Technologies Inc, Re,* [5] the Alberta Securities Commission ("**ASC**") in *Pulse Data Inc, Re* [6] and the minority reasons of the BCSC in *Icahn* [7]).

Our discussion of these divergent views can be found here. The inconsistency of the above-noted regulatory decisions, together with various other concerns including the apparent "hollowing out" of corporate Canada,[8] has brought into question the interpretation and application of NP 62-202.

On March 14, 2013, each of the Canadian Securities Administrators ("**CSA**")[9] —which includes the Autorité des marchés financiers ("**AMF**")—and the AMF [10] issued alternative proposals to revamp the regime regulating SRPs in the context of defensive tactics. The AMF proposal went further in advocating a new approach to regulating all defensive tactics, while the CSA indicated that it would address other defensive tactics as part of an ongoing CSA review. The dueling proposals of the CSA and the AMF reflect different philosophical approaches to the regulation of SRPs in the context of defensive tactics. The approach adopted by the CSA proposal recognizes that an SRP may be adopted for broader, longer-term purposes when approved by a majority of shareholders (represented to some extent by NP 62-202 itself, which provides that "shareholder approval of corporate action would, in appropriate circumstances, allay" concerns that actions of a board are abusive of the capital markets, [11] and also represented by the decisions in *Neo and Pulse Data* and the minority reasons of the BCSC in *Icahn*). The AMF's approach may be considered to be board-centric or corporate-centric, whereby regulators would defer to the decision of a target board in responding to a take-over bid provided that the board had in place appropriate safeguards to manage conflicts of interest.

There remains a significant difference of opinion between the CSA and AMF on the approaches identified in their proposals, and the differences have been publicly articulated. [12] Our discussion of the CSA and AMF proposals can be found here. In addition, the comment letters issued in response to the proposals have also reflected a significant difference of opinion. A discussion of our firm's comment letter can be found here. In light of these circumstances, it is not clear that the needed changes to NP 62-202 will be forthcoming in the

near term.

Background to *Augusta* decision

Augusta is an exploration and development company with one material property, that being the Rosemont copper project located in Arizona (the "**Rosemont Project**"), which is expected to be one of the largest copper mines in the United States. Augusta has been working on obtaining the permits and authorizations required to develop the Rosemont Project since July 2007 and, at the time of the hearing, was reported to be in the last stages of permitting. While there was significant disagreement as to when the permits would be granted, [13] both parties agreed that the permits would ultimately be obtained.

In the summer of 2010, Augusta issued common shares and warrants to HudBay on a private placement basis. Following this private placement, HudBay held approximately 11% of the outstanding common shares.

In late February 2013, after Augusta had received most of the required permits, HudBay tried to initiate another private placement with Augusta. When Augusta declined, HudBay began purchasing common shares of Augusta on the Toronto Stock Exchange (the "**TSX**"). In a four-week period, culminating on April 16, 2013, HudBay increased its holdings from 11% to over 15% of the common shares of Augusta.

In response to HudBay's announcement on April 17, 2013 that it had acquired an ownership position in Augusta of approximately 15%, Augusta's board of directors (the "**Board**") adopted the Plan, as a defence tactic to thwart any future acquisition of shares or a take-over bid by HudBay. An ownership level of 15% would activate the Plan, but HudBay's existing 15% ownership position was grandfathered so as to not trigger the Plan, provided HudBay did not acquire any additional shares.

Consistent with TSX requirements, in October 2013, Augusta held a special meeting at which its shareholders approved the Plan, with approximately 82% of the shares present (excluding those held by HudBay) voting in favour of the Plan. (72% of the outstanding shares were voted.)

On February 9, 2014, HudBay announced its intention to make the Bid and formally launched it the next day. Notwithstanding that two of its eight directors were members of management, Augusta determined that it need not form a special committee of independent directors to review the Bid. The Board believed that the participation of the two executives "would be instrumental in Augusta's ability to find strategic alternatives" and had agreed to establish a special committee of directors if a conflict of interest in respect of a director arose. [14]

On February 24, 2014, the Board unanimously determined to formally recommend that Augusta's shareholders reject the Bid. Augusta issued a press release announcing its recommendation, and also announced that directors, officers and shareholders holding over 33% of the Augusta shares (collectively, the "**Augusta Group**")

would not tender to the Bid. By the time of the BCSC hearing, the Augusta Group's holdings had fallen to approximately 30%.

On March 14, 2014, HudBay extended the expiry date of the Bid and waived its original 2/3 minimum tender condition. The result of this waiver was that HudBay would be permitted to acquire any shares tendered, assuming all Bid conditions were then satisfied or waived. HudBay's testimony at the hearing was that the minimum tender condition had been waived in recognition of the Augusta Group's ability to render the condition unattainable.

On March 28, 2014, Augusta announced that it would voluntarily seek to have the Plan reaffirmed by its shareholders in the face of the Bid at its annual shareholders' meeting scheduled for May 9, 2014. If shareholder approval was not obtained from a majority of the shareholders (excluding HudBay), the Plan would be terminated; if approval was obtained at the meeting, the Plan would be subject to shareholder approval annually.

HudBay subsequently announced that it was making a "final extension" of the Bid to May 5, 2013—85 days from the date the Bid was announced.

On April 8, 2014, Augusta advanced the date of its shareholders' meeting to May 2, 2014 to preserve the ability of Augusta's shareholders to vote in advance of the expiry of the Bid on whether the Plan should continue.

On April 14, 2014, after the Bid had been outstanding for 64 days with no competing offers publicly arising, HudBay made an application to the BCSC, Augusta's principal securities regulator, requesting to have the Plan cease-traded before the scheduled May 5th expiry of the Bid.

The hearing on the BCSC commenced on April 29, 2014, but was adjourned to May 2, 2014 so that the BCSC could consider the results of the shareholder vote.

At the May 2, 2014 shareholders' meeting, the Augusta shareholders approved the continuation of the Plan, with approximately 78% of all the shares voting (or 59% excluding HudBay and the Augusta Group): approximately 74.9% voted to affirm the Plan (94% if HudBay's shares were excluded, and 88.4% if the shares held by both HudBay and the Augusta Group were excluded).

Decision

Before outlining its legal analysis of the case, the BCSC addressed head on the March 2013 CSA and AMF proposals and noted that it had "elected not to follow the changes in policy reflected in either of these proposals."[15]

In outlining the legal basis for its analysis, the BCSC noted that it agreed with the majority decision in *Icahn*,

including the holding in Icahn that the decisions in *Neo* and *Pulse Data* should not be interpreted to have reversed the prior cases that had considered when an SRP had to be ceased-traded. The BCSC observed that the factors outlined in *Royal Host Real Estate Investment Trust, Re* [16] remained helpful in determining when it was time "for a pill to go". The BCSC also noted that it agreed with the following statement in *Baffinland Iron Mines Corp, Re:*[17]

>Accordingly, in our view, Neo does not stand for the proposition that the Commission will defer to the business judgment of a board of directors in considering whether to cease trade a rights plan, or that a board of directors in the exercise of its fiduciary duties may "just say no" to a take-over bid. Such a conclusion would have been inconsistent with the provisions of NP 62-202 and the relatively long line of regulatory decisions that began with *Canadian Jorex*.[18]

However, in our view, *Baffinland* did not reverse the key principle of Neo, being that overwhelming and informed shareholder approval of an SRP in the face of a hostile take-over bid may be determinative in deciding not to exercise a securities regulator's public interest power pursuant to NP 62-202.

In any event, in considering the factors enumerated in *Royal Host*, the BCSC viewed the following factors as the most relevant and noted the following in connection with each:

a. *Length of time Augusta had to identify a superior transaction:*The Bid would be outstanding for 85 days by its expiry on May 5, 2014, which was longer than the 60 days set out in the definition of "permitted bid" under the Plan and "at the outer limit of historical decisions of Canadian securities regulators for leaving rights plans in place in order to allow boards to pursue alternative transactions" [19] and therefore this factor weighed in favour of granting HudBay's application. While the BCSC noted that the fact that the completion of the permitting process on the Rosemont Project required more months was not a reasonable basis for not exercising its cease-trade power, it chose to defer implementation of the cease-trade order until a date subsequent to the anticipated time of completion of permitting as had previously been disclosed by Augusta.
b. *Likelihood that, if given more time, a superior transaction would be unearthed by Augusta:* Based on the evidence, including, that interested parties had expressed a reluctance to make an offer until permitting issues had been resolved at the Rosemont Project, no deadline had been set for definitive proposals, no form of definitive agreement had been sent out to prospective bidders and no negotiations had commenced towards a definitive agreement, the BCSC held that "there did not appear to be a real and substantial possibility of [20]Augusta obtaining a higher offer. In addition, the BCSC noted that Augusta had not formed a special committee (independent of management), describing it as "unusual" and questioning how seriously Augusta was in fact pursuing an alternative transaction.
c. *Whether the Bid was coercive:* The BCSC held that a bid without a minimum tender condition could not

be coercive "where a significant minority shareholder 'blocking position' exists". [21] Nevertheless, the BCSC held that where a minimum tender condition is removed and there were questions regarding the dynamics of different 'blocking positions', then it would be appropriate to issue a cease-trade order conditional upon the hostile bidder agreeing to a 10-day extension if it took up any target shares. In this case, HudBay agreed to provide such a 10-day extension.

d. *Shareholder Approval*: The BCSC emphasized that shareholder approval is merely one factor to be considered and noted that the weight attributed to shareholder approval will depend upon a number of factors, including (i) whether the SRP was approved in the face of a specific bid, (ii) whether approval was an informed one, (iii) the context of the vote in relation to the bid, (iv) the level of shareholder participation, and (v) the level of shareholder approval, particularly after excluding interested parties. In this instance, shareholder approval had been obtained in the face of the Bid, and approval levels were consistent with the prior approval levels for the Plan obtained at the October 2013 shareholders' meeting. Second, the BCSC noted the vote was clearly an informed one "on the key concept"[22] of voting to block the Bid. The context of the vote was also clear in that Augusta's shareholders fully understood that in voting in favour of the Plan, they would be impeding the Bid. In terms of voter turnout, the BCSC noted that this was of "significant importance" and in this case, the voter turnout was "very high"—nearly 80% of the outstanding Augusta shares and more than 50% of the public float. With respect to the approval level, the BCSC found it significant that votes in favour of the Plan represented a majority of the issued and outstanding shares even assuming that shares that had not been voted had instead been voted against the Plan. In terms of shareholder approval, the BCSC held that this factor "supported the notion that the Plan should not be cease-traded with immediate effect." [23]
e. *Likelihood of extension of the Bid:* The BCSC noted that it was a significant factor in determining not to cease-trade the Plan immediately that there was "a reasonable possibility of the Bid being extended if we decided that we would issue an order cease-trading the Plan effective at a future date certain." [24]

The BCSC concluded that it could balance the will of shareholders with the right of individual shareholders to be able to decide whether to accept the Bid, as it was reasonably likely that the Bid would be extended if the Plan was cease-traded effective as of a date in the future. The BCSC choose a date in the future that was consistent with Augusta's previously stated timeframe for completing the permitting process for the Rosemont Project.

Observations

1. In following the majority decision in *Icahn*, it is clear that the BCSC believed that it had only two choices: cease-trade the Plan immediately or at a specific date in the future; that is, to decide not if but when the Plan had to go. With Augusta having obtained overwhelming and informed shareholder approval, the

implementation of a cease-trade order could be delayed provided it was reasonable to assume that HudBay would extend the Bid. It would therefore appear that if HudBay had steadfastly taken the position (as was done in *Icahn* by the hostile bidder) that it would not extend the Bid, the Plan would have been cease-traded with immediate effect.

2. The BCSC's refusal to follow either of the March 2013 proposals of the CSA and the AMF is not surprising in light of the fact that both proposals have been subject to significant debate and criticism. It would clearly have been inappropriate to adopt a proposed regulation that will not likely be adopted in the form proposed. Nevertheless, it was open to the BCSC to consider the underlying policy of the CSA proposal and move closer to the reasoning in *Pulse Data*, *Neo* or the minority decision in *Icahn*. The fact that the BCSC choose to continue with the *Icahn* line of reasoning may not bode well for adoption of a new regulation with respect to defensive tactics.
3. The decision further highlights the need for consistency in the regulation of defensive tactics across the country. It is not clear that the result would have been the same if this matter had been decided by either the OSC or the ASC.
4. It would appear that British Columbia continues to be the friendliest jurisdiction in Canada for hostile bidders. Based on this decision, a hostile bidder for a target, which has the BCSC as its principal regulator, should likely proceed on the following basis: (i) do not make a permitted bid; (ii) ensure that an application to cease-trade the SRP is not made until after the bid is open for more than 60 days; (iii) emphasize before a hearing that the bid will be withdrawn and not extended if the SRP is not cease-traded with immediate effect; and (iv) ensure that the bid has an appropriate minimum tender condition unless there exists potential adverse blocking positions, in which case the minimum tender condition can be removed provided that the bid allows for an automatic 10-day extension once any shares are taken up by the bidder.
5. The "usual" practice of target companies forming a special committee of directors independent of management to consider all hostile bids remains important not just in connection with a board's proper exercise of its fiduciary duty, but also because the failure to do so will likely result in the securities regulators drawing an adverse inference as to the board's motivations.

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1 An order confirming the terms of the May 2, 2014 oral decision was issued on May 5, 2014. See *HudBay Minerals Inc and Augusta Resource Corporation, Re* 2014 BCSECCOM 153.[ps2id id='1' target=''/]

2 *HudBay Minerals Inc and Augusta Resource Corporation*, 2014 BCSECCOM 154 [*Augusta*].[ps2id id='2' target=''/]

3 2010 BCSECCOM 494 [*Icahn*].[ps2id id='3' target='/]

4 (1992), 15 OSCB 257.[ps2id id='4' target='/]

5 (2009), 32 OSCB 6941 [*Neo*].[ps2id id='5' target='/]

6 2007 ABASC 895 [*Pulse Data*].[ps2id id='6' target='/]

7 2010 BCSECCOM 494 (in determining whether to exercise their public interest discretion, "commissions can take a broader view and, in appropriate circumstances, also consider the collective long term interests of shareholders as a whole" at para 19).[ps2id id='7' target='/]

8 See e.g. "'Hollowing out' is hardly a myth", Toronto Star (30 January 2008), online: <http://www.thestar.com/opinion/2008/01/30/hollowing_out_is_hardly_a_myth.html>; Harry Arthurs, "The Hollowing Out of Corporate Canada: Implications for Transnational Labour Law, Policy and Practice" (2009) 57 Buff L Rev 781.[ps2id id='8' target='/]

9 *Proposed National Instrument 62-105 Security Holder Rights Plans*, CSA Notice, (2013) 36 OSCB 2643 (14 March 2013).[ps2id id='9' target='/]

10 *An Alternative Approach to Securities Regulators' Intervention in Defensive Tactics*, AMF Consultation Paper (14 March 2013).[ps2id id='10' target='/]

11 *Notice of National Policy 62-202 and Rescission of National Policy Statement No 38 Take-Over Bids – Defensive Tactics*, (1997) 20 OSCB 3525.[ps2id id='11' target='/]

12 See Bertrand Marotte, "Battle for Osisko highlights regulatory failings, Quebec watchdog says", *The Globe and Mail* (17 April 2014), online: <http://www.theglobeandmail.com/report-on-business/industry-news/energy-and-resources/battle-for-osisko-highlights-regulatory-failings-quebec-watchdog-says/article18055824/>.[ps2id id='12' target='/]

13 Augusta believed that the permits would all be obtained by the end of June 2014, whereas HudBay believed that it would take much longer.[ps2id id='13' target='/]

14 Affidavit of Christopher MH Jennings, Lead Director of Augusta at para 7 (22 April 2014).[ps2id id='14' target='/]

15 *Augusta, supra* note 2 at para 36.[ps2id id='15' target='/]

16 (1999), 22 OSCB 7819 [*Royal Host*].[ps2id id='16' target='/]

17 (2010), 33 OSCB 11385 [*Baffinland*].[ps2id id='17' target='/]

18 Ibid at para 51.[ps2id id='18' target=''/]

19 *Augusta, supra* note 2 at para 44.[ps2id id='19' target=''/]

20 *Ibid* at para 51.[ps2id id='20' target=''/]

21 *Ibid* at para 54.[ps2id id='21' target=''/]

22 *Ibid* at para 69.[ps2id id='22' target=''/]

23 *Ibid* at para 76.[ps2id id='23' target=''/]

24 *Ibid* at para 78.[ps2id id='24' target=''/]

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.