Legal update

Poison pills and go-shops: Alberta decision analyzes when shareholder rights plan “must go”

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Corporate finance and securities

On October 14, 2011, the Alberta Securities Commission (ASC) issued its written decision regarding the Afexa Life Sciences Inc. shareholder rights plans in connection with competing takeover bids for Afexa. The decision is interesting in that it provides a useful summary of the considerations involved in terminating shareholder rights plans, and in particular focuses on the key question of the timing of when such plans “must go.” In its decision, the ASC held that the Afexa shareholder rights plans could survive to the end of a 30-day “go-shop” period, but no longer.

Background

Afexa was the subject of two competing offers for its common shares by Paladin Labs Inc. and a subsidiary of Valeant Pharmaceuticals Inc. Paladin launched a hostile bid for any or all Afexa common shares on August 10, 2011, which was open for acceptance until September 14, 2011, initially and then extended to September 28, 2011 (the Paladin Offer). The Paladin Offer was for $0.55 per share or 0.013 Paladin common share for each Afexa share tendered and had no minimum tender condition. At the time of launching its offer, Paladin owned 14.95 percent of Afexa’s common shares. Afexa’s board of directors rejected the offer and characterized it as coercive.

The Afexa board sought alternatives to the Paladin Offer. On August 30, 2011, it entered into a support agreement with Valeant pursuant to which Valeant agreed to make an offer for all Afexa common shares at a price of $0.71 per share (the Valeant Offer). It was a condition of the Valeant Offer that 66 ⅔ percent of the Afexa common shares be tendered. The support agreement with Valeant contained a go-shop provision which allowed Afexa to solicit potential superior proposals until September 29, 2011. A data room was opened and eight confidentiality agreements were entered into during the auction process.

Paladin then announced its intention to increase its offer, but only if two shareholder rights plans Afexa had put in place were waived or cease-traded. After the ASC hearing had commenced, Paladin indicated the increased price to be $0.81 or 0.0217 Paladin shares per Afexa common shares. Valeant subsequently increased its offer to $0.85 per share conditional on Afexa agreeing to reduce the minimum tender condition.

Afexa had adopted two shareholder rights plans (collectively the Rights Plans). The first plan was approved by shareholders in March of 2010 and would be triggered by the acquisition of 20 percent or more of Afexa common shares other than by a “permitted bid,” which was defined as a bid open for at least 60 days and which contained an irrevocable minimum tender condition of more than 50 percent of the Afexa common shares. The second rights plan

was tactical and adopted two days after the launch of the Paladin Offer. It would be triggered by the acquisition of 15 percent of Afexa's common shares. Its stated purpose was to limit the ability of an investor to gain effective control of Afexa through "coercive and opportunistic methods." The second plan was not approved by shareholders and stopped Paladin from acquiring any more common shares of Afexa.

The positions of the parties

Paladin sought an order from the ASC to cease-trade the Rights Plans immediately as they were an obstacle to an auction. Afexa and Valeant argued that the Rights Plans should remain in place as the auction was continuing and it was in the shareholders' best interests that the plans remain in place. They further argued that the lack of a minimum tender condition in the Paladin Offer was coercive as shareholders would feel they might be stuck with their shares if they did not tender to the offer. Afexa and Valeant also asserted that the lack of a minimum tender condition meant that Paladin, if not restrained, could build up its position and effectively thwart other bidders as the Afexa shares were widely held and thinly traded in the market.

The decision

Factors to be considered in terminating a rights plan

The ASC, in concluding that the Rights Plans would remain in place until September 30, 2011, the day following the termination of the go-shop clause in the Valeant transaction, effectively recognized the go-shop provision as an adequate time period for an auction. The purpose of the takeover bid regime, the ASC reiterated, is to protect the bona fide interests of a target company's shareholders and the termination of a shareholder rights plan by the commission must be considered with this principle in mind. The ASC noted that plans have been upheld in the past where the continuation of a plan offers the real possibility of enhancing shareholders' choices and increasing the consideration shareholders would receive. The ASC also recognized that at some point such plans must terminate and shareholders must decide whether to tender to an offer or not. Each situation must be accessed on its own facts.

The ASC outlined factors to be considered in determining whether a rights plan should be terminated. These included whether shareholders had approved the plan in question, when the plan was adopted, the shareholder support for the plan, the complexity of the target, other defensive tactics used, the number of potential and viable offerors, the activity undertaken by the target to find an alternative transaction and the likelihood such a transaction would be found, the nature of the bid, the length of time since it was announced and whether the bid would be extended if the decision was made not to cease-trade the rights plan.

The go-shop provision and the rights plans

In considering the Afexa offers, the ASC determined that the auction process itself was at or nearing an end, as was the go-shop period — which was to end six days after the hearing. The ASC found that the Rights Plans, together with the 30-day go-shop provision, had worked in the interests of Afexa shareholders in unlocking a competing bid, but that the utility and value of the Rights Plans were nearing the point at which they must go. In this regard, the ASC found as follows:

> We consider that the Rights Plans, coupled with the Go-Shop Period arrangement, have worked in the interests of Afexa shareholders by enabling Afexa to generate an additional bid. However, at the time of the hearing, it was clear to us that the Rights Plans did, or very soon would, impede the further maximization of shareholder value by effectively preventing Afexa shareholders from receiving the intended enhanced offer announced by Paladin. In other words, the time had come (or very shortly would) at which the Rights Plans would limit rather than enhance shareholder choice and value. In our view the public interest favoured allowing the two competing offers to unfold without the hindrance of the Rights Plans.

Thus, as the ASC concluded that the auction was at or nearing an end, it was unlikely there would be new offers. Afexa shareholders would, at that point, know what their options were. The Rights Plans were preventing or soon would prevent Afexa shareholders from being able to make a choice. While the ASC acknowledged that the Afexa board had fulfilled its fiduciary obligations, the ASC, consistent with the general position of other commissions, based its decision on its determination of the public interest, rather than deferring to the business judgment of the Afexa

board. This decision is the first to analyze in such depth the effectiveness and timing of a go-shop in the context of an auction and its affect on the timing of the cease trade of a target's rights plan.

Other findings

Separately, the ASC did not accept the argument that the Paladin bid was coercive by virtue of certain of its features, including the fact it did not contain a minimum tender condition. The ASC rejected this argument, comparing the no minimum tender condition to a bid with a waivable minimum tender condition, and was of the view that the absence of such a condition did not make the bid coercive. With respect to Valeant's concern that Paladin's creeping bid could permit Paladin to acquire just under 20 percent of shares and then withdraw its bid, the ASC accepted Paladin's evidence that its goal was to acquire 100 percent of Afexa and its actions were not in themselves coercive. Furthermore, the ASC did not view the accumulation by Paladin of a further five percent of shares (to 19.95 percent) as obtaining a blocking position. With respect to the minimum condition of 66 ⅔ percent in the Valeant offer, the ASC stated it is not their role to assess the financial terms or desirability of a particular transaction. Finally, the ASC confirmed that its role was to assess when the Rights Plans should terminate and it was not necessary that their decision agree with the directors' decision.

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