BANKING ON CORPORATE

BY NEILL MAY

Out fiduciary outs

All of us have routines and habits that are comfortable, and there's usually no reason to question them. Most weekday mornings, and even some weekends when I have something to do other than think about corporate law, I carefully tie a colourful piece of expensive silk around my neck and tuck it up gingerly under my collar. I don't do it because it feels good, or because it occurred to me that putting fragile fabric right under my chin was sensible. I do it because I am used to it, and just about every other male hustling around the ant-farm-like tunnels under our office buildings does the same. We just do it, and don't think about it.

Customs like this, and there are a lot of them, usually have a rationale rooted in history and rich in mythology. Sometimes that rationale isn't worth questioning (why do men need to give a diamond ring when proposing — do I really want to be the one raising my hand on this one?). Sometimes, though, the rationale for a custom deserves a little sunlight. And so I turn my focus to "fiduciary out" provisions. No need to thank me for doing this, it's why I'm here.

It's common practice in Canadian public M&A deals to have a "fiduciary out" clause in the agreement between a buyer and the target (the latter being the company proposed to be sold). Very simply, a fiduciary out contractually affirms the target's directors' duty to act in the best interest of the target by giving them the right to withdraw their support for the deal if a better deal comes along.

To put this in perspective, buyers of public companies have two basic choices: they can make a bid directly for a target's shares without the support of the target's board (often called a hostile bid), or they can go to the target's board first and seek its support (in this latter type of "friendly" deal, the negotiation is not between the buyer and the sellers, but rather between the buyer and the board of directors of the company owned by the sellers, which is an important distinction in this context). Sometimes, approaching the board before making a bid to shareholders is just about getting the board's support for the deal in the form of a recommendation; other times, it involves putting matters in motion to implement the deal where the relevant majority of shareholders has committed to sell and the board's actions make the deal a *fait accompli*.

Think about it — if the concept is driven by directors' obligations to act in the best interests of the target, what if the best, or even the only, deal available is one where the buyer won't accept a fiduciary out? Isn't the directors' duty as fiduciaries to accept? Why can't a director contract out of her ability to exercise her fiduciary duty in the future where doing so is the only way to discharge that duty now? If fiduciary outs have to be in agreements, why don't the buyers need them? What if

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In that context, "fiduciary outs" began to appear in merger agreements. The rationale is that as fiduciaries of the target, directors must always be able to act in the best interests of the company, which may include embracing a better deal if one arises prior to the first deal closing. This rationale, along with the inertia that causes certain forms of legal documents to be reused, proved convincing enough to make fiduciary outs ubiquitous in the Canadian public M&A market (in our firm, we call the reliance on a tested and comfortable form "Norm Schipper drafting," a tribute to a senior commercial lawyer who in the early days of the firm drafted the forms of agreement that we use and reuse from scratch). The presence of precedents like Norm's on our document system is like the arrival of Croatian mercenaries in Paris in the 17th century: suddenly, everyone's wearing a "cravat." It is thus *de rigueur* for boards to condition their support for a deal on the inclusion of a fiduciary out.

Precedents are a great place to start, but drafting shouldn't necessarily end there — especially with fiduciary outs. circumstances change for the buyer and the deal is no longer in its best interest? And yet fiduciary outs for buyers' boards are rare.

There's little case law in Canada, and there won't be, of course, until someone breaks rank, opens the top button, and takes off the tie (and perhaps gets sued). Maybe then we will see that going without a tie makes sense sometimes (though given my own circumstances I know enough to stop there and not suggest that people ponder shirtlessness).

This argument doesn't make life any easier for directors, who would doubtless be subjected to intense scrutiny for sealing a deal so hermetically. That, of course, doesn't mean it isn't worth asking the question.

For now, though, I'm going to keep imitating my favourite mercenaries. CL

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