BANKING ON CORPORATE

BY NEILL MAY

Pills but no perfect cures

It seems to me successively younger generations have less patience for answers. It may be people need quick answers to cope with the increasing pace and volume of available information. Perhaps instant access to limitless information on smartphones has conditioned people to expect immediate answers. Or maybe this is just my impression because when I foist my interminable and soporific “insights” on young people, I misapprehend their understandable irritation for impatience.

For some questions, however, there are no quick answers. These impossible questions can be broken down into two categories: simple questions that are truly unanswerable, like why are round pizzas delivered in square boxes, why are buildings not called “builts,” and why the doctor who is about to check your prostate and test for a hernia leaves the room while you disrobe. On the other hand, there are those questions that, in spite of their difficulty, we continue to ponder, like how to regulate takeover bids.

Takeover bids are complicated. Regulatory policy in Canada has for many years reflected the view that defensive tactics may be taken by the board of directors of a target company in a genuine attempt to obtain a better bid, but the regulators should intervene where such tactics are likely to deny or severely limit the ability of the shareholders to respond to a takeover bid. Regulators believe shareholders must have an opportunity to participate in an offer. This approach is based on classic “agency theory” — the interests of the directors and officers (the agents) are not perfectly aligned with the shareholders’.

As a result, the board is permitted to try to achieve a better outcome for the company, and to use defensive measures in its attempt to do so, but ultimately should get out of the way to let shareholders decide whether to tender a bid. With that policy in place, takeover bid battles in Canada have tended to be fought in a certain way: the target board uses a shareholder rights plan, or “poison pill,” to buy time in order to seek an alternative outcome and/or try to obtain better value for shareholders, with securities regulators ultimately intervening to nullify a poison pill to permit the bid to go to shareholders, even where the board considers the bid not to be in the company’s best interests. The question in Canada is not *if* the poison pill would go, but *when*.

Other jurisdictions have adopted different approaches. In some cases boards of issuers subject to a hostile bid have many options to impede a takeover bid, including the power to “just say no.” In those jurisdictions, battles for control over companies are often fought in shareholder votes for board elections, and in courtrooms where boards’ actions are scrutinized. In other jurisdictions, by contrast, boards have even fewer powers than Canadian boards.

There has long been debate about the proper approach. Last summer two regulatory proposals were made in Canada concerning defensive tactics, effectively continuing the debate. The Canadian Securities Administrators published a proposal that would permit a board to use a shareholder rights plan to “just say no” to a hostile bid, provided the board has formal shareholder support. Quebec’s securities regulatory, the Autorité des marchés financers, went further, proposing courts would determine the propriety of shareholder rights plans and other defensive tactics as part of their jurisdiction over the discharge of directors’ fiduciary duties and securities regulators would only intervene where a board’s actions are abusive of shareholder rights or negatively affect the efficiency of the capital markets.

Very recently, the Quebec government waded further into the debate, announcing plans to move quickly to propose legislative amendments designed to better position Quebec companies to deter, and protect themselves from, unsolicited takeover bids. The government’s announcement was made in conjunction with a report released by the Task Force on the Protection of Québec Businesses, which emphasized the importance to the Quebec economy of having companies with head offices there. The proposals include permission for corporations to adopt provisions that would prohibit a company that has been subject to a takeover bid not approved by its board from undertaking certain transactions, making it more difficult for a hostile bidder to assume control and finance its bid.

The Quebec proposals go to the core of how much influence or control boards of directors should have in relation to unsolicited takeover bids. Directors’ interests may not be perfectly aligned with the shareholders, but at the same time the board may be well positioned to assess (not to mention duty-bound to act in) the best interests of the corporation. But the Quebec proposals also introduce another element into the question: a significant portion of the commentary about boards’ defensive tactics has focused not on the ivory tower puzzle as to whether boards, in discharging their fiduciary duty to the corporation, should be able to “just say no” to a hostile bid, but on the hollowing out of Canadian head offices as a result of the limitations on boards’ use of defensive tactics.

Layering protection of domestic industry into the defensive tactic debate is not going to make the answer any easier (or faster). The questions about the right approach to takeover bids may be like the classic question of why Wile E. Coyote did not just buy Acme roadrunner meat in a can and save himself a lot of trouble . . . there would be no fun in that. Maybe we should start with easier questions, leaving the use of poison pills for later and focusing on pills to remove the mental imagery from hernia exam references. CL

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