

CANADA

## Defensive tactics in Canadian M&A

BY CLAIRE SPENCER



M&A activity has reached record levels in Canada, and part of the surge has been driven by a rise in unsolicited or hostile bids over the last two years. In November 2006, Xstrata acquired Falconbridge for C\$20bn and CVRD bought Inco for C\$19.8bn. More recently, Norilsk Nickel made a \$6.8bn offer for LionOre Mining and Alcoa made a \$28bn bid for Alcan, which was trumped in August 2007 by a \$38.1bn offer from Rio Tinto. Hostile bids are still a minority, but they have become more prevalent – particularly when a foreign bidder is involved.

Until recently, hostile bids for Canadian companies were rarely cross-border. Stephen H. Halperin, a partner at Goodmans LLP, points to several reasons for the change. “First, competition for strategic targets in consolidating, globalising industries has resulted in an ‘eat or be eaten’ mentality. Second, there is an increased willingness on the part of bidders to forego the benefits of access to target management and other due diligence access to confidential information. Third, bidders are less willing to give up after unsuccessful attempts at friendly negotiations. Fourth, bidders know they are likely to deal with only a handful of target shareholders. Finally, there

is a perception by prospective bidders that hostile bids have a greater likelihood of success in Canada,” he says.

On the other hand, unsolicited offers can lead to nothing for the hostile bidder. In all hostile bids made between 1998 and 2006, a change of control took place in 82 percent of cases, but the hostile bidder was only successful in around half of those. The other half saw a ‘white knight’ acquirer take control. This means, however, that Canadian companies rarely remain independent once a hostile bid has been launched.

Although domestic M&A activity is dispersed through all sectors, cross-border deals have tended to focus on natural resources. Canada is famed for its resource-based economy and has many attractive targets in these industries. The failed merger between Canada’s two largest base metal producers, Inco and Falconbridge, led to two hostile takeovers, by CVRD of Brazil and the Anglo-Swiss Xstrata respectively. The failure of this all-Canadian merger reignited the protectionist debate that has been raging (on and off) for the last three decades.

Some Canadians are unhappy with the current situation, according to Terence S. Dobbin, a partner at Ogilvy Renault LLP. “There has

been some political outcry over what is seen as the loss of iconic Canadian companies,” he observes. “In July 2007, the federal government created a ‘Competition Policy Review Panel’ to review Canada’s competition and investment policies, including the treatment of state-owned enterprises and the possibility of including national security as a reason for investment review. The government couched this development carefully by saying policies should ‘encourage even greater foreign investment’ and ‘create more and better jobs for Canadians’.” The legislation on foreign ownership is fairly welcoming, except for protected and sensitive industries such as banking, telecommunications, publishing and broadcasting. Nonetheless, many believe that current regulations leave Canadian companies virtually defenceless against hostile takeovers.

According to Mr Halperin, the corporate balance favours shareholders over management. “Shareholders can elect and remove directors by simple majority votes, and enjoy a highly liberalised proxy solicitation regime which encourages shareholder consultation and concerted action. Legal remedies against directors for acting in a manner that is prejudicial to unfairly disregard the interests of shareholders or constitutes a breach of fiduciary duties ought to be sufficient to protect the interest of shareholders in this context.” As a consequence, management and the board of directors have limited powers to stave off takeover threats.

It is much easier to complete a hostile takeover in Canada than in the US. The use of shareholder rights plans, or ‘poison pills’, to protect a company from bids not supported by the board either before or during the period in which a bid is made, prevent shareholders from accepting a bid in the US. In Canada, the board of directors cannot turn away a bid without first submitting it to shareholders, and Canadian securities regulators can generally terminate the pill after 45 days. Interestingly enough, during Xstrata’s unsolicited bid for Falconbridge, the Ontario Securities Commission allowed the poison pill to remain in place

in order to prevent Xstrata from increasing its ownership of Falconbridge to a position that could deflect other bids, giving the Falconbridge shareholders a worse deal.

Other defences seen elsewhere are of limited use under Canadian law. Staggered boards, for example, are completely ineffectual. Share buybacks are not considered unless they are offered to all shareholders on an equal basis. Measures designed to obstruct an unsolicited bid are not tolerated for lengthy periods of time. Often the only hope of defence for the board is that major shareholders will turn down the bid, accept a more attractive bid from a solicited source, or negotiate a higher price that negates the hostility of the original bid. Whatever the options, it is almost inevitable that the company will be sold on, notes Mr Dobbin. "Once a company is perceived to be 'in play', there is usually tremendous change in a company's shareholder base as arbitrage investors move into the stock. Arbitrage investors tend to be immune to the powers of persuasion, at least when it comes to taking a long-term view, so there tends to be more of a focus on generating an alternative value-maximising transaction," he says.

There are calls for regulators to re-evaluate several elements of Canadian corporate and securities law, particularly in the context of

hostile takeover bids. The aim is to restore confidence in senior executives and directors, which existing laws seem to imply has been lost. Mr Halperin encourages a reassessment. "As long as a board of directors has been elected to 'manage or supervise the management of the business and affairs of the corporation', and is not acting in a manner which is 'oppressive' or in breach of statutory fiduciary duties, the board should have broad latitude to respond to hostile bids in a manner which it believes to be in the best interests of the corporation," he says. "As a result of the combined effect of the legal regime, regulatory biases in favour of shareholder choice, and market dynamics that inexorably lead the takeover target to be owned by short-term, event driven shareholders with very little interest in strategic visions or long-term horizons, that is simply not possible."

Mr Dobbin agrees that the imbalance should be corrected. He argues that Canadian legislators and regulators have not provided boards with the same defences that are available to US companies to prevent a company from being put in play. "This imbalance should be considered in light of the modern corporate governance environment, which features independent boards, fulsome disclosure, active and knowledgeable courts and intense scrutiny

from increasingly vocal and active shareholders," he says.

However, any changes should be enacted with great caution. Tinkering with the current framework could have unintended consequences. "Any fundamental alteration of Canada's foreign investment law would have an impact on how Canadian investment in other countries will be treated," says Mr Dobbin. "So we must tread carefully or we might actually hamper the ability of Canadian companies to expand internationally. Similarly, our corporate and securities laws are well evolved and protective of shareholders."

So while there is a widespread desire to reform Canadian M&A laws, experts acknowledge that a knee-jerk reaction must be avoided. Executives and boards deserve a higher level of faith in their decision-making capabilities, which should include the ability to determine whether or not a bid is in the best interests of shareholders. If they decide that the advances of a prospective acquirer should be rejected, they should be able to utilise the necessary takeover defences, supported by law. But if regulators go down this path, they must be careful not to overreact and seal off corporate Canada to foreign buyers by making it too easy for boards to dismiss any offer. ■



**Stephen H. Halperin**  
Partner  
T: +1 416.597.4115  
E: [shalperin@goodmans.ca](mailto:shalperin@goodmans.ca)  
[www.goodmans.ca](http://www.goodmans.ca)

**Goodmans**<sup>LLP</sup>  
Barristers & Solicitors / [goodmans.ca](http://goodmans.ca)

Stephen Halperin is a partner, member of Goodmans' Executive Committee and co-chair of its corporate securities practice group. He has more than 25 years' experience in transactional corporate and securities law, with a particular expertise in domestic and international corporate finance, mergers and acquisitions and corporate governance.

Representative clients and transactions include: Abitibi-Consolidated in its \$7.1 billion acquisition of Donohue; Mackenzie Financial in the successful defence of CI Fund Management's hostile takeover bid and subsequent C\$4.2 billion friendly bid for Mackenzie by Investors Group; Barclay Brothers in its bid for Hollinger; Coeur

d'Alene Mines in its unsolicited bid for Wheaton River; Royal Group Technologies in response to Cerberus' unsolicited proposal and C\$1.7 billion sale to Georgia Gulf; Fortress in its U.S. \$2.8 billion acquisition of Intrawest; Hummingbird in its \$500 million acquisition by Open Text; Avion Group in its successful, unsolicited C\$600 million acquisition of Atlas Cold Storage; KCP Income Fund in its C\$800 million acquisition by Caxton-Iseman and Norilsk Nickel in its successful, unsolicited C\$6.8 billion acquisition of LionOre Mining.

He is a past member of the Securities Advisory Committee of the Ontario Securities Commission, and a member of the Commission's Senior Securities

Lawyers Advisory Group. He taught Advanced Corporate/Securities Law at the University of Toronto Law School from 1992 to 1999.

Chambers Global ranks Steve as one of four Canadians with the 'star performer' (highest) rating for Corporate/M&A and he was named one of the top 25 capital markets lawyers in the world in Euromoney's 'Best of the Best'. He is listed in The Best Lawyers in Canada and is also consistently ranked as a leading corporate finance, corporate governance and M&A practitioner in survey-based publications worldwide. Steve is a member of the bars of, and has practiced in, Ontario, Quebec and Alberta.