

COLUMN: BANKING ON CORPORATE

Corporate redemption song

In this climate of economic uncertainty, the use of corporate cash to fund redemptions can raise questions about fiduciary duties

REDEMPTION HAS MANY different meanings depending on context. In a theological context, it can mean expiation or liberation from sin or from exile. For Bob Marley, it meant emancipation and aspiration for freedom. And, in corporate law, it means repurchase of stock, by far the sexiest of these three and another reason to wonder about personal choices to spend a lot of time reading corporate statutes.

In the current financial climate of pandemic-induced economic uncertainty, the accumulation and use of corporate cash to fund redemptions can raise questions about priorities and fiduciary duties, as reflected in the recent decision of the Delaware Court of Chancery in *The Frederick Hsu Living Trust v. Oak Hill Capital Partners*.

Oak Hill Capital Partners had a controlling interest (at both the stockholder and board levels) in ODN Holding Corporation, a holding company for Oversee.net. Its shareholders included preferred equity that carried a redemption right. Historically, the company had invested its cash resources in organic growth and to finance acquisitions, and its business plan at the time contemplated using cash for those purposes. However, Oak Hill was looking to monetize its investment, and the company's focus turned to cash generation and conservation. It sought to engage in a corporate merger that would have facilitated the raising of capital sufficient to fund the redemption, and when that did not succeed, the company proceeded to sell off various divisions (at prices that were not challenged at trial), including its principal source of profit, and used the resulting cash proceeds to fund the redemp-

tion of Oak Hill's preferred equity. Because of Oak Hill's conflict of interest, the sales and the use of the proceeds therefrom to redeem Oak Hill's preferred shares were approved by special committees of the board.

Frederick Hsu, the co-founder and second largest shareholder of the company, alleged that the board and management of ODN had breached their fiduciary duties by causing the company to accumulate cash rather than investing it to promote long-term growth. Judicial scrutiny of fiduciaries' conduct in

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the U.S. is different than in Canada, and the decision focused in material part on the strict standard of review that would apply; nevertheless, more generally, the conduct bore scrutiny because of the unique benefit that the controlling shareholder would itself enjoy from the strategy pursued.

The court determined that, had the company reinvested its cash in the business, it would not have generated value for itself and its stakeholders, as a result of headwinds in the industry and relentless competition. Support for this conclusion was provided by the fact that Oak Hill also had an incentive to maximize value, through its common equity interest in the company, and had in the court's view conducted itself not as a group content

to write off the balance of its investment but as a team motivated to make ODN succeed. The court acknowledged the “lottery-like possibility” that alternative uses of capital “might have achieved outsized success and created value for the common,” but it concluded that the company wasn't required to make a long-odds gamble. Because the defendants proved redemption “was the best use of the company's cash” that “inflicted no harm on the common stockholders,” the court found in favour of the defendants.

The case demonstrates that redemptions can be challenging and that parties unhappy with redemptions can turn a lens not just on the redemption but on the corporate actions leading up to the actual redemption. Moreover, the decision shows that the parties' motives and actions inform a comprehensive assessment of fiduciaries' conduct in an economic environment where challenges of corporate decisions can be expected to increase.

Perhaps Bob Marley's *Redemption Song* was about fiduciary duties after all, hinting to that effect in its opening line, “Old pirates, yes, they rob I.” These questions might have been

avoided if all concerned had used the word retraction, a term often employed to refer to redemptions that are initiated not by the corporation but by the shareholder. On the other hand, had the term retraction been utilized, you may have had to endure senseless babble from me about media retractions in a fake news era or medical phenomena that I'm not entirely qualified to address, so all things considered, maybe enduring a bit of confusion about redemption is tolerable. **CL**

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