McGill Law Journal
Revue de droit de McGill

The Future of Poison Pills in Canada: Are Takeover Bid Reforms Needed?

Anita Anand

Volume 61, numéro 1, september 2015

URI : https://id.erudit.org/iderudit/1035384ar
DOI : https://doi.org/10.7202/1035384ar

Aller au sommaire du numéro

Éditeur(s)

McGill Law Journal / Revue de droit de McGill

ISSN

0024-9041 (imprimé)
1920-6356 (numérique)

Découvrir la revue

Citer cet article

Anand, A. (2015). The Future of Poison Pills in Canada: Are Takeover Bid Reforms Needed? *McGill Law Journal / Revue de droit de McGill*, *61*(1), 1–29. https://doi.org/10.7202/1035384ar

Résumé de l'article

Les régimes de protection des droits des actionnaires, autrement connus sous le nom de « pilules empoisonnées », visent à protéger les actionnaires d'offres d'achat hostiles en permettant au conseil d'administration de se prévaloir d'une période de temps extraordinaire afin de considérer de nouvelles soumissions. Au fil des années, cette période est passée de vingt à trente-cinq jours. Récemment, les Autorités canadiennes en valeurs immobilières (ACVM) ont proposé d'établir une période fixe de 120 jours durant laquelle les actionnaires pourraient considérer toute offre d'achat soumise. Compte tenu des raisons historiques ayant poussé à réglementer les offres publiques d'achat, à savoir protéger certaines classes particulières d'actionnaires, cet article soutiendra que notre régime juridique devrait se garder de décréter une période de soumission aussi longue. Bien que d'autres éléments de la proposition de l'ACVM s'avèrent prometteurs, une période prolongée de soumission aura pour effet de désavantager à la fois les actionnaires ciblés et les soumissionnaires, et finira par dissuader ces derniers de se prêter au processus d'offres.

McGill Law Journal — Revue de droit de McGill

THE FUTURE OF POISON PILLS IN CANADA: ARE TAKEOVER BID REFORMS NEEDED?

*Anita Anand**

The rules regarding shareholder rights plans, also known as "poison pills", ensure that boards of directors facing a hostile takeover bid can retain a poison pill for a period of time in order to search for other potential offers. Over the years, the period of time has grown in length from twenty to thirty-five days and the Canadian Securities Administrators (CSA) have recently proposed a 120-day period during which takeover bids would remain open. In light of the historical rationale of takeover bid law to protect the interests of target shareholders, this article argues that the legal regime should not allow an extensive bid period of 120 days. While other aspects of the CSA proposal are sound, a lengthy bid period disadvantages both target shareholders and bidders and will ultimately deter bids from occurring.

Les régimes de protection des droits des actionnaires, autrement connus sous le nom de « pilules empoisonnées », visent à protéger les actionnaires d'offres d'achat hostiles en permettant au conseil d'administration de se prévaloir d'une période de temps extraordinaire afin de considérer de nouvelles soumissions. Au fil des années, cette période est passée de vingt à trente-cinq jours. Récemment, les Autorités canadiennes en valeurs immobilières (ACVM) ont proposé d'établir une période fixe de 120 jours durant laquelle les actionnaires pourraient considérer toute offre d'achat soumise. Compte tenu des raisons historiques ayant poussé à réglementer les offres publiques d'achat, à savoir protéger certaines classes particulières d'actionnaires, cet article soutiendra que notre régime juridique devrait se garder de décréter une période de soumission aussi longue. Bien que d'autres éléments de la proposition de l'ACVM s'avèrent prometteurs, une période prolongée de soumission aura pour effet de désavantager à la fois les actionnaires ciblés et les soumissionnaires, et finira par dissuader ces derniers de se prêter au processus d'offres.

* Professor, Faculty of Law, University of Toronto and Fellow-in-Residence, CD Howe Institute. Email: anita.anand@utoronto.ca. Thanks to participants at Blake, Cassels & Graydon LLP and the CD Howe Roundtable in February 2015 for helpful comments. Thanks also to Grant Bishop, Hal Jackman, Vijay Jog, Naizam Kanji, Daniel Schwanen, and Michael Trebilcock for comments and to Joshua Freedman, Krupa Kotecha, Duncan Melville, Andrew Mihalik, and William Muir for excellent research assistance funded by the Social Sciences and Humanities Research Council of Canada.

Citation: (2015) 61:1 McGill LJ 1 — Référence : (2015) 61:1 RD McGill 1

Introduction

When faced with an unwanted acquisition proposal, a target board of directors may seek shareholder approval for a shareholder rights plan or "poison pill" to prevent acquisitions of its securities above the twenty per cent legislative takeover bid threshold.[1] The pill provides time for the target board to negotiate with the bidder for an enhanced bid, to solicit competing bids, or to propose some other alternative to its shareholders.[2] In the absence of a higher offer from the bidder and no alternatives coming forward, case law says that "the pill has got to go"[3] and the original bidder can proceed with its proposed acquisition transaction.[4] But poison pills, even those ratified by shareholders ex ante, can remove the decision about whether a bid proceeds from the hands of shareholders, leaving it to rest with incumbent target management and the board, who may not necessarily act in the shareholders' best interests.

The Canadian Securities Administrators (CSA) recently proposed a new framework for the regulation of takeover bids.[5] The framework contains the most significant reforms to the takeover bid regime in Canada in decades.[6] Under the proposal, takeover bids would have an irrevocable fif-

---

1 See *Securities Act*, RSO 1990, c S.5, s 89(1) [*OSA*].

2 See Marcel Kahan & Edward B Rock, "How I Learned to Stop Worrying and Love the Pill: Adaptive Responses to Takeover Law" (2002) 69:3 U Chicago L Rev 871.

3 *Re Royal Host Real Estate Investment Trust* (1999), 8 ASCS 3672, online: ASC <www.asc.ca/Notices%20Decisions%20Orders%20%20Rulings/Issuers/6974_Royal_Host_Real_Estate_Investment_Trust_(The)_-_Reasons_-_1999-11-24.pdf> [*Royal Host*].

4 Certain cases have evidenced an alternative regulatory approach, but they are the exception rather than the norm (see e.g. *Re Neo Material Technologies Inc*, (2009) 32 OSCB 6941, 63 BLR (4th) 123 [*Neo*]; *Re Pulse Data Inc*, 2007 ABASC 895, 39 BLR (4th) 138 [*Pulse Data*]).

5 See *CSA Notice and Request for Comment: Proposed Amendments to Multilateral Instrument 62-104* Take-Over Bids and Issuer Bids*, Proposed Changes to National Policy 62-203* Take-Over Bids and Issuer Bids*, and Proposed Consequential Amendments*, OSC CSA Notice (31 March 2015), online: OSC <www.osc.gov.on.ca/documents/en/Securities-Category6/csa_20150331_62-104_rfc-proposed-admendments-multilateral-instrument.pdf> [CSA Proposal].

6 In terms of actual legislation, Canada's takeover bid regime was introduced following the significant recommendations contained in Ontario, *Report of the Attorney General's Committee on Securities Legislation in Ontario* (Toronto: Queen's Printer, 1965) [Kimber Report]. An important review of takeover bid legislation occurred in 1983 with the "Report of the Three Wise Men" (see Ontario, *Report of the Committee to Review the Provisions of the Securities Act (Ontario) Relating to Take-Over Bids and Issuer Bids* (Toronto: Ontario Securities Commission, 1983)). Further reforms to the regime occurred in 1997 after the introduction of the *Notice of National Policy 62-202 and Rescission of National Policy Statement No 38—Take-Over Bids—Defensive Tactics*, OSC NP 62-202, (1997) 20 OSCB 3525 [NP 62-202]. Prior to the CSA Proposal, the most recent review of takeover bid law in Canada occurred in 1996 with the introduction of what

ty per cent minimum tender condition and could remain open for a minimum of 120 days.[7] The fifty per cent condition means that a bid would succeed only if a majority of independent shareholders tendered their securities in response to the bidder's offer (securities of the bidder and its joint actors would not be counted in the fifty per cent). Once the condition is met, the proposed rules would require an additional ten-day right to tender for undecided shareholders.

In addition to containing substantive amendments to the legislative regime, the CSA Proposal represents a united front for the provincial and territorial jurisdictions that comprise the CSA. Indeed, some may legitimately view the CSA Proposal as a watershed moment in Canadian securities regulation. This observation is especially true given that on many issues—enforcement, the exempt market, and, until now, takeover bids—securities regulators across Canada have been unable to develop comprehensive rules with which all regulators agree. The CSA Proposal was released for comment but the CSA will likely be hard-pressed to amend the proposal in a material way given the difficulty in reaching the current compromise.[8] Thus, the CSA Proposal may well represent the takeover bid law that will ultimately apply across the country.

This article argues in favour of the majority approval requirement because it effectively implements collective decision making akin to a shareholder vote. The 120-day bid period, however, would cause uncertainty in the market to the detriment of both target shareholders and bidders. While the 120-day period is target friendly—giving acquisition target boards more time to evaluate a bid, search for other options, or ultimately recommend the bid's rejection—hostile bidders would be unreasonably exposed. Their bid for the target would remain open for a much longer pe-

---

are known as the Zimmerman amendments. Among other things, the Zimmerman amendments lengthened the bid period from twenty-one to thirty-five days (see Investment Dealers Association of Canada, *Report of the Committee to Review Take-Over Bid Time Limits* (Toronto: IDA, 1996)). For further history see Mary G Condon, Anita I Anand & Janis P Sarra, *Securities Law in Canada: Cases and Commentary*, 2nd ed (Toronto: Emond Montgomery, 2010) ch 2.

7 See CSA Proposal, *supra* note 5 at 2.

8 At one point in the process, the Autorité des Marchés Financiers (AMF) and the Ontario Securities Commission were divided in their approaches to the issues. For the early AMF position, see Québec, Autorité des Marchés Financiers, "An Alternative Approach to Securities Regulators' Intervention in Defensive Tactics" (Montréal: AMF, 14 March 2013), online: <www.lautorite.qc.ca/files//pdf/consultations/juin-2013/2013mars14-avis-amf-62-105-cons-publ-en.pdf> [AMF Report]. See also *CSA Notice 62-306: Update on Proposed National Instrument 62-105* Security Holder Rights Plans *and AMF Consultation Paper* An Alternative Approach to Securities Regulators' Intervention in Defensive Tactics, OSC CSA Notice, (2014) 37 OSCB 8229, which sets out some of the history.

riod than the current 35-day bid period and would allow considerable time for a white knight bidder to emerge with an alternative bid. Further, financial resources that the bidder has allocated to purchase the target's shares remain in limbo while the 120-day period transpires. In short, there appears to be little reason, at least within the confines of the objectives of securities regulation to protect investors and maintain market efficiency, to lengthen the bid period.

Part I examines relevant Canadian corporate and securities law that governs boards of directors in the takeover bid context. It also compares Canadian law with US law, which adopts a conspicuously different approach to the duties of the target board. Part II sets forth the rationale for poison pills, arguing that they may run contrary to the interests of target shareholders. Part III analyzes the CSA Proposal, contending that target shareholders should be able to decide for themselves (i.e., by tendering) whether a bid will succeed. To be clear, this article analyzes poison pills in relation to takeover bids that occur pursuant to securities legislation and that do not fall within an existing legislative exemption[9] or another aspect of business law (such as arrangements under the corporate statute[10]).

Before proceeding, an argument grounded in macroeconomic issues bears mentioning. Some argue that takeover bid law contributes to a "hollowing out" of the greater Canadian economy because directors of target boards have limited tools to defend against a takeover bid.[11] This argument may have merit, but even if it does, securities regulation is arguably an inappropriate legislative regime in which to address it. Statutorily, securities regulation seeks to protect investors and is a matter of provincial jurisdiction.[12] By contrast, issues relating to the health and welfare of the Canadian economy fall squarely under the federally enacted and adminis-

---

9 The exemptions are contained in *OSA*, *supra* note 1, ss 100–100.6. Poison pills are sometimes employed in relation to so-called "creeping takeover bids" made through normal course purchases and private agreement exemptions. Such bids are not the focus here.

10 See *Canada Business Corporations Act*, RSC 1985, c C-44 [*CBCA*].

11 Canada, Competition Policy Review Panel, *Compete to Win: Final Report* (Ottawa: Industry Canada, 2008) at 76.

12 See e.g. *OSA*, *supra* note 1, s 1.1. While this provision states that the mandate of the Ontario Securities Commission is to protect investors and to maintain market efficiency and confidence in capital markets, few would argue with the view that market efficiency in the context of securities regulation refers to efficient capital markets and does not include stability of Canada's financial markets from a macroeconomic perspective. The Supreme Court of Canada's securities decision in *Reference Re* Securities Act, 2011 SCC 66, [2011] 3 SCR 837 and the recent proposal for a cooperative securities regulator reemphasize the fact that the provinces maintain jurisdiction in this area.

tered *Investment Canada Act*.[13] In other words, a separate legislative regime exists to deal with foreign takeovers of Canadian firms. Admittedly, the federal regime has its weaknesses, including that it only applies to certain transactions that are above the review threshold and it also contains an ambiguous "net benefit" test. These weaknesses in the *ICA* require attention federally as securities regulators have no jurisdiction here, constitutionally speaking. Moreover, as will be evident from the discussion below, it is likely inconsistent with the board's fiduciary duty for it to prioritize concern for the Canadian economy above its duty to act in the best interests of the corporation.

Even if one believes that the securities regulatory regime *is* the proper venue in which to prevent a hollowing out, it is not clear that takeover bids, generally speaking, are a net negative for the domestic economy. On the contrary, many argue that corporate takeovers generate *positive* gains, including benefits for target shareholders in the form of premia over the pre-announcement price paid for securities.[14] In other words, the economic advantages of takeover bids to shareholders of the target, and to the economy generally, must be weighed against the alleged negative effects of foreign takeovers.[15] Once again, as it is primarily concerned with investor protection, the securities regulatory regime is not the proper forum in which the debate about hollowing out should occur.

---

13 RSC 1985, c 28 (1st Supp) [*ICA*]. This statute explicitly aims "to provide for the review of significant investments in Canada by non-Canadians in a manner that encourages investment, economic growth and employment opportunities in Canada" (*ibid*, s 2).

14 See e.g. Michael C Jensen & Richard S Ruback, "The Market for Corporate Control: The Scientific Evidence" (1983) 11 J Fin Econ 5; Gregg A Jarrell, James A Brickley & Jeffry M Netter, "The Market for Corporate Control: The Empirical Evidence Since 1980" (1988) 2:1 J Econ Persp 49; Martin Lipton, "Twenty-Five Years After *Takeover Bids in the Target's Boardroom*: Old Battles, New Attacks and the Continuing War" (2005) 60:4 Bus Lawyer 1369 at 1373; "Labour TDs to Meet Tomorrow over Aer Lingus Takeover Bid", *RTE News* (25 February 2015), online: <www.rte.ie/news/2015/0224/682378-aer-lingus/> (contending that the bid for Aer Lingus would be good for the Irish economy as a whole).

15 Admittedly, the macroeconomic effects of takeover bids are debatable. But see Gregg A Jarrell, "Takeovers and Leveraged Buyouts" in *Concise Encyclopedia of Economics*, 1st ed, online: Library of Economics and Liberty <econlib.org/library/Enc1/TakeoversandLeveragedBuyouts.html> who states after summarizing the debate: "These academic studies show clearly, on the basis of share prices, that hostile takeovers and highly leveraged transactions created huge increases in the values of companies. Moreover, several follow-up studies have shown that these stock-price gains are generally reliable predictors of real operating improvements and of increased corporate efficiency."

I. Takeover Bid Law

This section analyzes the complex law relevant to takeover bids in Canada, elucidating the importance of two areas: corporate law and securities regulation. It further examines the relationship between the two in terms of takeover bids and poison pills.

A. Corporate Law

The duties of directors in the context of a takeover bid can be understood first by referring to corporate law, under which directors' basic statutory obligation is to discharge their fiduciary duties honestly and in good faith with a view to the best interests of the corporation. Directors must also exercise the care, diligence, and skill that a reasonably prudent person would exercise in comparable circumstances.[16] This duty, which applies to boards of public and private corporations, is consistent across provincial corporate statutes in Canada. It must be read in light of the recent decision *BCE Inc. v. 1976 Debentureholders*,[17] in which the Supreme Court of Canada explained that the duty is owed to the corporation rather than to a particular stakeholder group within the corporation.[18] The Court explained that in any given instance, which would include a takeover bid, the board must have regard to "all relevant considerations", including: "the need to treat affected stakeholders in a fair manner, commensurate with the corporation's duties as a responsible corporate citizen."[19] While the Court does not define the term "stakeholders", it is clear that the term includes (but is not limited to) shareholders.[20]

The *BCE* case is broad and carries with it some ambiguity in terms of to whom directors' fiduciary duties are owed. Commentators have argued

---

16 See *CBCA*, *supra* note 10, s 122(1).

17 2008 SCC 69, [2008] 3 SCR 560 [*BCE*].

18 The Court makes clear that "the directors owe a fiduciary duty to the corporation, and only to the corporation[;] ... directors owe their duty to the corporation, not to stakeholders" (*ibid* at para 66).

19 *Ibid* at para 82.

20 See *ibid* at para 39. The Court builds on the decision in *Peoples Department Stores Inc (Trustee of) v Wise*, 2004 SCC 68, [2004] 3 SCR 461 [*Peoples*]. The SCC held that the board *may* consider the impact of corporate decisions on shareholders "or particular groups of stakeholders" (*BCE*, *supra* note 17 at para 39 [emphasis added]) which include "the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment" (*ibid*, citing *Peoples*, *supra* note 20 at para 42). For a thoughtful analysis of the treatment of employees in hostile bids, see Anthony Niblett, "Hostile Takeovers and Overreliance" (2015) 38:2 Seattle UL Rev 595.

that the *BCE* decision is "vague"[21] and "indeterminate".[22] What does it mean to say that directors owe their duty to the nebulous and intangible thing called a "corporation"? As a legal fiction, the corporation does not have meaning apart from the individuals who comprise it. A duty owed to all stakeholders dilutes the duty considerably. Ultimately, other than reiterating the wording of the corporate statute, the *BCE* decision provides directors with little clarity regarding to whom specifically their duties are owed.[23]

The case law regarding directors' duties is relevant because courts have viewed the adoption of a pill as being subject to the target board's exercise of its fiduciary duties.[24] Where shareholders have approved the pill prior to a bid being launched, directors' fiduciary duties are rarely questioned. But where the pill is "tactical" (i.e., adopted without shareholder approval), case law has indicated that the target board will be protected in its decision making by the business judgment rule, which in Canada is a rule about deference to the board. Courts will look to see that the decision was made within a "range of reasonable alternatives."[25] In adopting a defensive tactic such as a poison pill, or in evaluating a bid, the target board's process will be crucial and perhaps determinative of whether the board complied with its fiduciary duties. Did the board consider a range of options? Did the board open its data room to other potential bidders? What considerations did the board take into account in evaluating

---

21 Patrick Lupa, "The BCE Blunder: An Argument in Favour of Shareholder Wealth Maximization in the Change of Control Context" (2011) 20 Dal J Leg Stud 1 at 14.

22 Edward Iacobucci, "Indeterminacy and the Canadian Supreme Court's Approach to Corporate Fiduciary Duties" (2009) 48:2 Can Bus LJ 232 at 233. See also Jeffrey G MacIntosh, "*BCE* and the Peoples' Corporate Law: Learning to Live on Quicksand" (2009) 48:2 Can Bus LJ 255. MacIntosh states that, with respect to *BCE* and *Peoples*, "[a]lthough much of both decisions is *per incuriam*, *obiter dictum*, or both, these rulings have thrown the most basic principles of corporate law into a state of uncertainty and confusion" (*ibid* at 255).

23 See Iacobucci, *supra* note 22. See also Anita Anand, "The Relationship Between Investors and Corporations After the Financial Crisis" in Adolfo Paolini, ed, *Research Handbook on Directors' Duties* (Northampton, Mass: Edward Elgar, 2014) 321 at 328 [Anand, "Financial Crisis"].

24 See e.g. the US cases *Moran v Household International Inc*, 500 A (2d) 1346, 54 USLW 2271 (Del Sup Ct 1985); *Unocal Corp v Mesa Petroleum Co*, 493 A (2d) 946, Fed Sec L Rep (CCH) P 92077 (Del Sup Ct 1985) [*Unocal*]. See also *Maple Leaf Foods Inc v Schneider Corp* (1998), 42 OR (3d) 177, 44 BLR (2d) 115 (CA) [*Maple Leaf*]. The court in *Maple Leaf* held that directors must seek the best value reasonably available to shareholders, but there is no duty to auction. The court in the case reasoned that an auction is often the best way to achieve the best value, but not the exclusive way. In the case at bar, the board of directors acted in good faith and with reasonable investigation, and therefore received the benefit of the business judgment rule.

25 *BCE*, *supra* note 17 at para 40.

the long-term "best interests" of the corporation? As the Court stated in *BCE*, a board's decision on any particular issue must be reasonable, but it is not required to be perfect.[26]

B. Securities Regulation

BCE allows—perhaps forces—us to conclude that under corporate law, directors do not owe a duty shareholders alone.[27] But this holding is at odds with the legislative mandate of securities regulation, which states that securities commissions must protect investors and maintain market efficiency.[28] This group—that is, investors—is large. While it includes shareholders, it also includes anyone who is making a decision to invest in the capital markets more broadly. A conspicuous tension arises because corporate law states that directors must take into account the interests of many stakeholders in the corporation, while securities regulation suggests that they must focus on investor (and shareholder) interests specifically.[29]

It is not only the conflicting legal mandates between corporate and securities law that is problematic in terms of sorting through the law in this area. Even within legal regimes, the law is fragmented, complex, and difficult to understand. In securities law, applicable legislation is contained not only in the securities legislation of the particular province but also in a so-called "Multilateral Instrument", which is a piece of legislation that most, but not all, provinces have adopted as law in their own respective jurisdictions.[30] As Ontario has not signed on to the Multilateral Instrument, the provincial *Securities Act* applies, despite the fact that it is largely consistent with the Multilateral Instrument. The CSA Proposal, if adopted, would include Ontario's signing on to the Multilateral Instrument, which would therefore subsequently be termed a "National Instrument" given its otherwise unanimous approval in all other jurisdictions.[31]

---

[26] *Ibid* at para 112.

[27] See Anand, "Financial Crisis", *supra* note 23 at 324–29.

[28] See *OSA*, *supra* note 1, s 1.1.

[29] See Robert Yalden, "Canadian Mergers and Acquisitions at the Crossroads" (2014) 55:3 CBLJ 389. Yalden agrees that the objectives of corporate law and securities regulation are at odds.

[30] As one refers to "takeover bid law", it may appear as though there is one body of law. In reality, the law is fragmented; *Multilateral Instrument 62-104* Take-Over Bids and Issuer Bids, OSC MI 62-104 governs takeover bids in all jurisdictions in Canada, except Ontario, where Part XX of the *OSA*, *supra* note 1 and *Ontario Securities Commission Rule 62-504*: Take-Over Bids and Issuer Bids, OSC Rule 62-504, (2008) 31 OSCB 1289 govern takeover bids.

[31] See CSA Proposal, *supra* note 5 at 30.

The CSA's National Policy 62-202 is also relevant, but it is a policy and is not binding as law.[32] Finally, there is no guarantee that securities regulatory authorities in individual provinces will follow the decisions of their counterparts in other jurisdictions. Each commission is staffed with individuals who, from time to time, have been known to have differing approaches relating to enforcement.[33]

It is within this convoluted area of law that defensive tactics fall. Takeover bid law has evolved to mean that directors cannot simply reject a hostile bid. Rather, they need to present, or attempt to present, shareholders with alternatives rather than only one possible transaction. National Policy 62-202 articulates two underlying principles regarding a board's implementation of takeover defences. First, it states that unrestricted auctions produce the most desirable results in takeover situations. Second, it states that shareholders of the target company should generally be given the opportunity to determine the ultimate outcome of the hostile bid.[34] Consistent with these two principles, Canadian securities commissions have historically allowed target boards to use defensive tactics solely to attempt to obtain a better bid by creating an auction to improve the price that shareholders will receive for their shares.[35]

By contrast, the United States, and particularly Delaware, affords more deference to the business judgment of directors, providing them with a great deal of flexibility in responding to takeover bids.[36] Under Delaware

---

[32] See NP 62-202, *supra* note 6. This distinction between law and policy in securities regulation is particularly important after *Ainsley Financial Corp v Ontario Securities Commission* (1994), 21 OR (3d) 104, 121 DLR (4th) 79 (CA).

[33] For an excellent study regarding differing philosophies in enforcement, see Mary Condon, "The Use of Public Interest Enforcement Orders by Securities Regulators in Canada" in A Douglas Harris, ed, *Wise Persons' Committee to Review the Structure of Securities Regulation in Canada: Research Studies* (Ottawa: Department of Finance, 2003). Recently, the Province of Alberta announced that it will enforce the decisions of other provinces, suggesting that consistent enforcement across the country did not previously exist (see Barbara Shecter, "Alberta Becomes First Province to Automatically Reciprocate Capital Markets Sanctions", *Financial Post* (3 July 2015), online: <business.financialpost.com/news/fp-street/alberta-becomes-first-province-to-automatically-reciprocate-capital-markets-sanctions>).

[34] See NP 62-202, *supra* note 6.

[35] See *ibid*, which states: "The take-over bid provisions should favour neither the offeror nor the management of the target company, and should leave the shareholders of the target company free to make a fully informed decision." Note that the CSA Proposal does not seek to amend NP 62-202.

[36] See *Notice and Request for Comment: Proposed National Instrument 62-105* Security Holder Rights Plans, *Proposed Companion Policy 62-105CP* Security Holder Rights Plans*, and Proposed Consequential Amendments*, OSC CSA Notice, (2013) 36 OSCB 2643, Schedule A [Notice 62-105]. For the UK, see The Panel on Takeovers and Mer-

law, if a court determines that a board of directors acted in good faith and in accordance with its fiduciary duties, the board is legally entitled to preserve the long-term strategic goals of the corporation. This is true even if a majority of shareholders favours an alternative approach.[37] Once it becomes apparent that the target company will be sold or broken up, however, the board's duty shifts to maximizing shareholder value, either by negotiating for improved bid terms or by seeking out and proposing an alternative transaction.[38]

Boards in the United States are entitled to "just say no" to a proposed bid and to use defensive tactics, such as poison pills, to prevent (as opposed to simply delay) a bid.[39] American courts have typically held that target directors have properly satisfied their fiduciary duties when they are not acting in their own self-interest, have reasonable grounds for believing that a particular threat to the corporation exists, adopt reasonable measures to address the threat posed, and act diligently on the basis of expert independent advice and full and complete information.[40] By contrast, the poison pill jurisprudence discussed in the next section suggests that boards in Canada have not been permitted to "just say no".[41]

As in Canada, US boards are protected by the business judgment rule but the rule differs between jurisdictions. In the United States, the business judgment rule is a presumption that protects directors and officers from liability as long as the impugned transaction is made in good faith

---

gers, *The Takeover Code* (London: The Panel on Takeovers and Mergers, 2013), online: <www.thetakeoverpanel.org.uk/the-code/download-code>. *The Takeover Code* places many more restrictions on the target board than would apply in Canada. It "prohibits a target company board from taking any action during a bid, or in anticipation of a bid, that would frustrate the take-over bid or otherwise deny shareholders the opportunity to decide on its merits, unless such action is approved by target company shareholders in the face of the bid" (Notice 62-105, *supra* note 36 at 2659).

37 See *Paramount Communications Inc v QVC Network Inc*, 637 A (2d) 34, 62 USLW 2530 (Del Sup Ct 1994) [*Paramount*].

38 See *Revlon Inc v MacAndrews & Forbes Holdings Inc*, 506 A (2d) 173, 54 USLW 2483 (Del Sup Ct 1986) [*Revlon*].

39 See Kahan & Rock, *supra* note 2.

40 See Kevin J Thomson, Lisa Damiani & Richard Fridman, "When 'No' Means 'Maybe': The State of the 'Just Say No' Defence in Canada" in *2011 Lexpert/American Lawyer Guide to the Leading 500 Lawyers in Canada* (Toronto: Thomson Reuters, 2011), online: Davies Ward Phillips & Vineberg LLP <www.dwpv.com/~/media/Files/PDF_EN/2014-2007/Davies_Ward_-_When_No_Means_Maybe.ashx>.

41 The jurisprudence on this point emerges from securities commission cases, as discussed in the next section. This is a point to which the AMF responded in AMF Report, *supra* note 8.

and with reasonable skill and prudence.[42] The US rule shifts the onus to the plaintiff and away from the defendant directors.[43] In Canada, the business judgment rule means that courts will give a high degree of deference to the board's decisions where the board weighs the risks and benefits prudently and on a reasonably informed basis.[44] The Canadian rule is therefore an added layer of deference accorded to boards in this country as opposed to an onus-shifting device that would be applied ex post once boards are found to have acted in good faith.

Thus, as explained in this section, the law applicable to takeover bids in Canada spans both corporate and securities law, unlike in the United States where directors' responses to a takeover bid are governed by corporate law alone. Yet these two areas of law manifest inconsistencies that are especially conspicuous in the takeover bid context. On the one hand, corporate law states that directors owe their duty to the corporation. On the other hand, securities regulation is premised on ensuring that investors' interests are protected, which in turn means that the rules promulgated as well as cases decided by securities regulators will have this objective in mind.[45] The interplay between these fundamental aspects of corporate law and securities regulation is complex, as evidenced by the law relating to poison pills discussed in the next section.

---

[42] See *Shlensky v Wrigley*, 95 Ill App (2d) 173, 237 NE (2d) 776 (1968); *Otis & Co v Pennsylvania R Co*, 61 F Supp 905, 1945 US Dist LEXIS 2089 (Pa Dist Ct 1945).

[43] For discussion of the onus-shifting device inherent in the US context, see A Douglas Harris et al, *Cases, Materials and Notes on Partnerships and Canadian Business Corporations*, 4th ed (Toronto: Thomson Carswell, 2004) at 342. Note that in the context of a hostile takeover bid, courts will apply the more stringent test in *Unocal*, *supra* note 24. It is also referred to as intermediate scrutiny. Prior to *Unocal*, the Delaware courts had applied the business judgment rule to takeover defences, mergers, and sales. In *Unocal*, it was held that a board of directors may only try to prevent a takeover if it can be shown that there is a threat to corporate policy and the course of action taken to prevent the takeover is proportional and reasonable given the nature of the threat. The decision in *Unocal* was, in many ways, a response to the reaction following *Paramount*, *supra* note 37, which was criticized because it allowed the directors to focus on the longer term, rather than the shorter term, in deciding what to do. Subsequent Delaware cases such as *Unocal* have greatly confined the ability of directors to focus on the long term, encouraging them to focus on what is best for shareholders in the short term. See also *Revlon*, *supra* note 38.

[44] See *Peoples*, *supra* note 20 at paras 64–67.

[45] See Yalden, *supra* note 29.

II. Poison Pills

It will aid the examination of the CSA Proposal in Part III to analyze the rationale underlying poison pills generally as well as the case law relating to pills in Canada.

A. Underlying Rationale

Poison pills are a type of defensive tactic that enable the corporation to shield itself against hostile or unwelcome bidders. By adopting a poison pill, the target board deters potential acquirers from purchasing twenty per cent (i.e., the threshold that triggers the takeover bid rules) or more of the target's shares. The pill makes the acquisition expensive and is attractive for the board and management who may believe that a bid is not in the best interests of the corporation.[46] They may wish to steer the corporation away from the bid and toward another transaction or approach for the corporation. In Canada, defensive tactics provide the board with flexibility to respond to the takeover bid rather than to eschew it altogether.

The target corporation's shareholders may adopt a poison pill prior to any hostile bid being launched or they may be asked to do so in the face of a bid (a so-called "tactical" pill). Once shareholders ratify the pill, technically the decision to trigger it rests with the board. In reality, this outcome rarely persists as the hostile bidder typically attempts to negotiate with the target or launches a proxy contest to replace the target board altogether. To be sure, if triggered, the poison pill would allow existing shareholders, except the bidder, to purchase shares at a discount so as to dilute the bidder's holdings in the target.[47] In this way, the pill (and by implication, the legal rules that permit the use of this defensive tactic) discriminates (or allows discrimination) as between the bidder qua shareholder and all other shareholders of the target. This discrimination runs contrary to the principle of equal treatment in securities regulation that is embodied in provisions such as the identical consideration provision (which ensures that all shareholders receive the same price for their shares) and the pro rata take-up rules (which require bidders making partial bids to prorate their take-up of tendered shares in the event that the

---

[46] See Jordan M Barry & John William Hatfield, "Pills and Partisans: Understanding Takeover Defenses" (2012) 160:3 U Pa L Rev 633 at 642.

[47] This is known as a "flip-in" provision (the most common type), which typically states that, upon the acquisition of a certain percentage (ten or twenty per cent) of the target's outstanding securities, each right other than those held by the bidder entitles its holder upon payment to acquire the target's securities having a market value equal to some multiple (e.g., two times) of the exercise price (see *ibid*; "Poison Pill", *Macacabus*, online: <www.macabacus.com/defense/poison-pill>).

number of tendered shares exceeds the number of shares contained in a partial bid).[48]

What then is the original rationale for poison pills? These defensive tactics were meant to prevent hostile bidders from encouraging target shareholders to tender to an unreasonably low bid. In theory, the pill makes it prohibitively costly for the hostile bidder to obtain control of the target without the target board's cooperation.[49] But the pill also places a wedge between the bidder and the target shareholders to whom it has made the offer. It puts management and the board in the driver's seat by increasing the cost of the bid and by forcing the bidder to negotiate with the board as opposed to the shareholders. The pill allows management and the board to bargain on behalf of shareholders to seek out a higher or more attractive offer so that shareholders do not fall prey to the tactics of the hostile bidder.[50] Without a pill, a bidder could exploit coordination problems among widely disseminated shareholders and pay less for control than if the target were to face an auction.

But placing the bargaining power with the board and management gives rise to a concern that these groups may be conflicted in terms of their loyalties.[51] As Weisbach explains: "Managerial entrenchment occurs when managers gain so much power that they are able to use the firm to further their own interests rather than the interests of shareholders."[52] As a rational, self-interested actor, the agent may well act in his or her own best interests rather than in the corporation's, regardless of his or her ongoing fiduciary duty.[53] In the face of a hostile takeover bid where they

---

48 See *OSA*, *supra* note 1, ss 97(1), 97.2(1). For an overview of the principle of equal treatment in securities regulation, see Anita Anand, "Regulating Issuer Bids: The Case of the Dutch Auction" (2000) 45:1 McGill LJ 133. On the point of the discriminatory effects of poison pills, see Jeffrey G MacIntosh, "Poison Pills in Canada: A Reply to Dey and Yalden" (1991) 17:3 Can Bus LJ 323 at 334ff [MacIntosh, "A Reply"], written in reply to Peter Dey & Robert Yalden, "Keeping the Playing Field Level: Poison Pills and Directors' Fiduciary Duties in Canadian Take-Over Law" (1991) 17:2 Can Bus LJ 252. Note, however, that it appears that no court or securities commission has struck down a poison pill on the basis that it discriminated among shareholders qua shareholders.

49 See Jeffrey G MacIntosh, "The Poison Pill; A Noxious Nostrum for Canadian Shareholders" (1989) 15 Can Bus LJ 276 at 278–79 [MacIntosh, "Nostrum"].

50 See *ibid*; Dey & Yalden, *supra* note 48. Some may question what the proper role of the board is, if shareholders have the sole say in whether to tender to the bid. The board should evaluate the bid(s) and make a recommendation to shareholders.

51 See Kimber Report, *supra* note 6 at paras 3.01ff; *347883 Alberta Ltd v Producers Pipelines Ltd* (1991), 80 DLR (4th) 359, 3 BLR (2d) 237 (Sask CA) [*Producers Pipelines*].

52 Michael S Weisbach, "Outside Directors and CEO Turnover" (1988) 20 J Fin Econ 431 at 435.

53 As Jensen and Meckling explain, if both parties to an agency relationship "are utility maximizers there is good reason to believe that the agent will not always act in the best

may lose their positions following a change of control, management and the board may make efforts to perpetuate themselves in their respective offices.[54] They may simply seek to retain their current position or even to "extract higher wages and larger perquisites from shareholders, and obtain more latitude in determining corporate strategy."[55]

The concern with management entrenchment provides the historic rationale of takeover bid law in Canada.[56] Yet some may question the validity of the management entrenchment hypothesis. First, the theory is based in agency cost analysis, but it cannot be proven definitively: one cannot determine with certainty that directors and management seek to entrench themselves in any given situation. Second, the theory ignores senior managers' and directors' attempts to fulfill their fiduciary duties. The Ontario Securities Commission has recognized that target boards of directors genuinely attempt to fulfill their fiduciary duties to the corporation, holding that a measure of deference should be accorded to board decisions.[57] However, it is not necessarily the case that directors will be unconflicted in the takeover context; when faced with a hostile bid, directors may indeed seek to entrench themselves. The question is not whether managers and the board will in fact put their own interests ahead of the corporation and its stakeholders but rather whether this possibility may arise. As long as management and the board have the opportunity to prioritize their own interests above the corporation's, the concept of management entrenchment remains relevant.

---

interests of the principal" (Michael C Jensen & William H Meckling, "Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure" (1976) 3:4 J Fin Econ 305 at 308).

54 See *Producers Pipelines*, *supra* note 51; MacIntosh, "Nostrum", *supra* note 49 at 281. In the era of high executive compensation, the managerial entrenchment hypothesis (MEH) continues to have force and relevance. See also Yvan Allaire, "Coutnerpoint: Canada Needs a New Regime for Hostile Takeovers", *Financial Post* (30 April 2014), online: <business.financialpost.com/2014/04/30/counterpoint-canada-needs-a-new-regime-for-hostile-takeovers/>. Allaire seems to suggest that the MEH has less, not more, relevance in today's world: "[T]he quaint notion that management is, *ipso facto*, against the takeover of its company because of inherent conflicts of interest must be updated" (*ibid*). Yet Allaire does not explain the ways, if any, in which this may be true. As long as agents run a corporation (i.e., a legal fiction), one will need to be concerned with agents seeking to entrench themselves.

55 See Andrei Shleifer & Robert W Vishny, "Management Entrenchment: The Case of Manager-Specific Investments" (1989) 25:1 J Fin Econ 123 at 137. While the existence of golden parachutes may make senior management less reluctant to abdicate their positions, there is as of yet no empirical study indicating that this is indeed the case.

56 See Kimber Report, *supra* note 6; *Producers Pipelines*, *supra* note 51.

57 See *Neo*, *supra* note 4 at paras 91, 103.

In response, one could ask: why not strip senior management and the board of their powers and let shareholders make all major decisions? As argued below, takeover contests are not the ordinary course of business. On the contrary, they disrupt the ordinary course, possibly permanently. Given that there is a change of control on the immediate horizon, takeovers intensify the threat of management entrenchment as directors and senior managers contemplate a potential loss of board seats or employment. Thus the applicable legal regime must minimize the impact of potential conflicts of interest at the board and senior management levels.

B. Applicable Law

As noted above, the legislative rationale for poison pills in Canada is set forth in National Policy 62-202, which articulates two underlying principles regarding a board's implementation of takeover defences. First, unrestricted auctions produce the most desirable results in takeover situations. Second, shareholders of the target should generally be given an opportunity to determine the ultimate outcome of the hostile bid by making a fully informed decision.[58] As a consequence of these two governing principles, Canadian securities commissions have historically allowed target boards to use defensive tactics solely to attempt to obtain a better bid, rather than to reject a bid outright. To some extent, the CSA Proposal is consistent with these two principles, as will be seen below.

While these principles underpin takeover bid jurisprudence, it should be recognized that cases proceed under the nebulous public interest power, which allows securities regulators broad leeway to determine whether a transaction, or other market conduct, is in the "public interest".[59] These cases are fact-specific: each decision turns on the specific facts of the case and these facts always differ.[60] Securities commissions, which are administrative bodies that are not required to adhere to a system of precedent, have held that a number of factors must be considered in making the determination of whether a defensive tactic can remain in place, including: whether the bid is coercive or unfair to target shareholders; when the pill was adopted; whether the board obtained shareholder approval of the pill; and the status of any auction process being conducted by the target in or-

---

[58] See NP 62-202, *supra* note 6.

[59] *OSA*, *supra* note 1, s 127. For examination of the history and case law relating to this provision, see also Anita Anand, "Carving the Public Interest Jurisdiction in Securities Regulation: Contributions of Justice Iacobucci" (2007) 57:2 UTLJ 293 [Anand, "Carving the Public Interest"].

[60] See *Royal Host*, *supra* note 3.

der to source a higher offer.[61] This case-specific approach has injected unwelcome uncertainty into the market.

For example, in *Re Icahn Partners LP*, the British Columbia Securities Commission held that a target board cannot rely on the fact that a majority of its shareholders approved a pill in order to maintain the status quo where the board has not taken steps to seek any competitive bid or alternative transaction for the target's shareholders.[62] Similarly, in *Re Baffinland Iron Mines Corp.*, the Ontario Securities Commission held that poison pills are contrary to shareholder interests unless their implementation is tied to a bona fide attempt to obtain a superior offer.[63] The respective commissions in these cases sought to ensure that target shareholders have choice regarding the sale of the company in which they invested.

Other cases, such as *Pulse Data* and *Neo*, suggest that regulators may give more latitude to target boards (as opposed to shareholders) in their use of poison pills, particularly if an unsolicited bid is partial or coercive in nature or if shareholders have made an informed decision to approve the pill subsequent to the bid being made.[64] The Ontario Securities Commission refused to cease trade a pill in *Neo*, reasoning that, while the main purpose for adopting a pill traditionally had been to allow the board to pursue alternative value enhancing transactions, "shareholder rights plans *may* be adopted for the broader purpose of protecting long-term interests of the shareholders, where, in the directors' reasonable business judgment, the implementation of a rights plan would be in the best interests of the corporation."[65]

While *Pulse Data* and *Neo* represent a departure from the poison pill jurisprudence in Canada, they have not displaced the case-specific approach in determining whether to maintain or cease trade a pill and, more generally, in analyzing the duties of the board in the face of an unsolicited bid. The uncertainty embedded in the case-specific approach potentially hampers bids, since market participants cannot know ex ante what rules will apply to their bid, whether the bid will be permitted to proceed, or

---

61 See *ibid* at 19.

62 2010 BCSECCOM 432, [2011] BCWLD 5807.

63 (2010), 33 OSCB 11385, 77 BLR (4th) 143.

64 See *Pulse Data*, *supra* note 4; *Neo*, *supra* note 4. The Ontario Securities Commission conspicuously treads into the area of fiduciary duties in *Neo*, *supra* note 4, by analyzing and applying *BCE*, *supra* note 17.

65 *Neo*, *supra* note 4 at para 112 [emphasis in original]. As an aside, this judgment indicates that securities commissions do, at times, tread into the area of adjudicating fiduciary duties. This issue is addressed in Part III below.

what the corresponding timeframe will be. Arguably, decisions about takeover bids should not rest only with the board or with the regulator but with those who are most affected by the transaction: the target shareholders.

It is true that shareholders are not unprotected in a hostile bid; securities regulators can intervene on behalf of shareholders[66] and a bidder qua shareholder, or together with shareholders that support its bid, may also be involved in the litigation to invalidate a pill. In *Fibrek*,[67] for example, a hostile bidder launched a bid for the target, and three shareholders who owned forty-six per cent of the target's shares entered into a "hard lock-up" with the bidder; this meant that the total support for the target's shares was over fifty per cent.[68] The target did not at the time have a poison pill in place, but the target board subsequently struck an independent committee and approved one.[69]

About eight weeks after the launch of the bid, the Québec Bureau de décision et de révision (the Bureau) issued an order to remove the target's poison pill.[70] The following day, the target announced that it had entered into an agreement with a white knight who proposed to purchase the target's common shares and receive warrants under a private placement. The original hostile bidder applied to the Bureau for a cease trade order of the white knight's offer and the private placement. The Bureau allowed the offer to proceed but did cease trade the private placement, given the dilution effect that it would have. On appeal, the Court of Quebec reversed the Bureau's decision because it focused only on shareholders who had signed the lock-up but not all of the shareholders.[71] The Quebec Court of Appeal overturned this decision, upholding the Bureau's decision to disallow the private placement and allowing the majority of shareholders to obtain control of the target.[72]

---

66 See Marvin Yontef, "Takeover Bid Defences: Issuing Securities to a Friendly Party—The Canadian Experience" (2013) 28:3 BFLR 319.

67 *AbitibiBowater inc (Produits forestiers Résolu) c Fibrek inc*, 2012 QCCA 569, 100 BLR (4th) 265, leave to appeal to SCC refused, 34757 (18 April 2012) [*Fibrek*].

68 *Ibid at* paras 9–10.

69 See *ibid* at paras 11–12.

70 See *ibid* at paras 22–26.

71 See *ibid at* paras 27–28.

72 See *ibid* at para 44. See also Robert M Yalden & Emmanuel Pressman, "Quebec Tribunal Concludes Fibrek Inc. Response to Unsolicited Bid Went Too Far" (14 June 2012), online: Osler, Hoskin & Harcourt LLP <www.osler.com/en/resources/critical-situations/2012/quebec-tribunal-concludes-fibrek-inc-response-to>.

In the subsequent case of *HudBay*, the British Columbia Securities Commission allowed a pill to remain in place for an unprecedented period of time because it had shareholder approval.[73] Almost seventy-five per cent of target shareholders and ninety-four per cent of shareholders who were not acting jointly with the bidder voted in favour of retaining the pill. Shareholders of the target, Augusta, sought to ensure that a competing bid could come forward, and the securities regulator accepted this choice. The *HudBay* decision is consistent with National Policy 62-202 in allowing the target time to seek another offer, especially when target shareholders prefer this approach.[74] In some cases, this may mean that a pill is cease traded, but in others, it may mean that the pill stays in place. Shareholders made the decision in *HudBay*, but it took litigation and regulatory intervention to reach this result.

The poison pill case law has resulted in complex, inconsistent, and ambiguous law: neither bidder nor target can know definitively ex ante whether a bidder's request to the commission for it to cease trade a pill will be decided in the affirmative or the negative. One could argue that uncertainty is not necessarily wholly disadvantageous to the target shareholders if it results from a period during which the board is exploring alternatives. While this argument has merit, it does not take into account the potential for management and the board to search for alternatives that are more self-serving than the original offer. The lengthier the bid period, the more leeway for the board to delay or forgo decisions that may be in the shareholders' best interests. Indeed, as argued below in reference to the 120-bid period proposed by the CSA, these are decisions that should rest with shareholders given the extraordinary implications for shareholders themselves. This argument does not imply that *every* takeover bid should be treated identically, but that the decision about an individual takeover bid should be made on the basis of how many shareholders have tendered to the bid itself.

Some may contend that policy choices in this area should be determined with reference to the empirical literature. Jeffrey MacIntosh has persuasively argued, however, that the "available evidence on the effects of poison pills, taken in its totality, is highly consistent with the manage-

---

73 *Re HudBay Minerals Inc*, 2014 BCSECCOM 153 (CanLII) [*HudBay*].

74 See Adrian Myers, "Regulators Should Get Out of Takeovers", *The Globe and Mail* (11 June 2014), online: <www.globeinvestor.com/servlet/WireFeedRedirect?cf=GlobeInvestor/config&vg=BigAdVariableGenerator&date=20140611&archive=rtgam&slug=escenic_19130540>. As Myers explains, "Augusta's board should be able to comply with the wishes of shareholders not to tender through strong takeover defences. ... A truly 'shareholder centric' approach to regulation would create an environment that puts incumbents and bidders on equal footing, empowering shareholders to collectively determine the fate of their ownership interest" (*ibid*).

rial entrenchment hypothesis."[75] The evidence would therefore dictate providing shareholders with more leeway in deciding the outcome of a takeover bid. Given that the purpose of securities law is to protect the interests of target shareholders, it is therefore reasonable to expect (as does the CSA Proposal) that target shareholders should be given the choice to accept or reject the pill—and, ultimately, the bid—for themselves. After all, the offer is made from the bidder to the target shareholders directly, and it is therefore not necessarily within the board's discretion to make the decision. As in *HudBay*, shareholders should be permitted to decide.

In light of the discussion above, one might legitimately ask why securities law (with its obligation to shareholders) should trump corporate law (with its duty to the corporation as a whole). Shareholders differ from other individuals with whom the corporation contracts, such as creditors. By virtue of purchasing shares, they are owners of the corporation. It is for this reason that shareholders are the conspicuous stakeholder in the corporate statute, as evidenced by their right to elect directors and appoint auditors.[76] We now turn to examine the argument in favour of shareholder decision making, as well as some contrary claims, with reference to the CSA Proposal.

III. Reform of Takeover Bid Regime?

In light of the uncertainty emanating from the case law, the question persists as to whether reform of Canada's takeover bid regime, including as contemplated in the CSA Proposal, is warranted. Is it the case that investors are better protected if boards of directors have the ability to "just say no" to a takeover bid by implementing a poison pill? Does the mandate of securities regulators require shareholder decision making in response to a hostile takeover bid? What role should securities regulators assume? In short, as these questions suggest, there are many arguments in favour of reform; this section reviews and responds to them.

A. Mandate of Securities Regulators

Do securities regulators have a mandate to regulate in the area of poison pills? The question arises in light of the criticism that securities regulators should cease to regulate defensive tactics because the duties of

---

[75] MacIntosh, "Nostrum", *supra* note 49 at 298. See also Frank H Easterbrook & Daniel R Fischel, "The Proper Role of a Target's Management in Responding to a Tender Offer" (1981) 94:6 Harv L Rev 1161.

[76] See *CBCA*, *supra* note 10, ss 106(3), 162.

boards are set out in the corporate statute and related case law.[77] Proponents of the idea that securities regulators do not have jurisdiction in this domain argue that the board's duty in corporate law is "to act honestly and in good faith with a view to the best interests of the corporation."[78] Referring to *BCE*, in which the Supreme Court reaffirmed the board's statutory duty, they argue that while the board's fiduciary duties are general, they are set by corporate statute and by the courts that interpret the statute, and this is where decisions about board conduct in a takeover bid (as in all other instances) should rest.[79] Thus, proponents argue that courts, not regulators, are the proper forum for the discussion of defensive tactics and board conduct in the area of takeover bids.

The explicit purposes of securities regulation are to protect investors from unfair, improper, and fraudulent practices and to foster fair and efficient capital markets.[80] In the takeover bid context, securities commissions' mandates look to increasing the ability of issuers (bidders and targets alike) to undertake mergers while protecting the interests of target shareholders in the capital markets. Securities commissions have no explicit jurisdiction to regulate or adjudicate in the area of the board's fiduciary duties; they generally recognize this fact.[81] National Policy 62-202 itself states: "The Canadian securities regulatory authorities have determined that it is inappropriate to specify a code of conduct for directors of a target company, in addition to the fiduciary standard required by corporate law."[82]

Yet there is an aspect of board conduct that falls within the realm of securities regulation. The Ontario *Securities Act* specifically provides that the Commission has the jurisdiction to prescribe "requirements respecting defensive tactics in connection with take-over bids."[83] In terms of a target board's responses to a takeover bid and its implementation of defensive tactics, there is thus overlap between corporate law and securities regulation because the law relating to defensive tactics directly relates to per-

---

77 See AMF Report, *supra* note 8 at 9–14.

78 *Ibid* at 9. See also *CBCA*, *supra* note 10, s 122(1)(a).

79 See CSA Proposal, *supra* note 5. See also Allaire, *supra* note 54.

80 See *OSA*, *supra* note 1, s 1.1 for the current mandate, which also includes the obligation to maintain market confidence. This obligation, in the author's view, likely results in efficient markets in which investors are protected. The purposes of takeover bid law derive from the Kimber Report, *supra* note 6.

81 See *Re Magna International Inc*, (2010) 34 OSCB 1290, 78 BLR (4th) 94 [*Magna*]; Anita Anand, "Was *Magna* in the Public Interest?" (2011) 49:2 Osgoode Hall LJ 311 at 315 [Anand, "*Magna*"]. For contrast, see *Neo*, *supra* note 4.

82 NP 62-202, *supra* note 6.

83 *OSA*, *supra* note 1, s 143(1)(28)(viii).

missible conduct by the board. Nevertheless, the text of securities legislation supports the conclusion that securities regulators do indeed have jurisdiction to regulate and decide cases in the area of defensive tactics.

From a legal perspective, therefore, it is not the case that securities commissions are overreaching when they decide cases in the area of defensive tactics. Furthermore, *BCE* says nothing about the inability of securities regulatory authorities to intervene as necessary to protect the interests of target shareholders. Rather, the case says that when the board is making a decision, it has a duty to take into account the interests of the corporation as a whole, including its stakeholders, rather than one stakeholder alone.[84] Thus, *BCE* does not mean that the board can circumvent regulatory processes and it certainly does not negate the public policy goals of securities regulation to protect investors and maintain market efficiency. Indeed, the Supreme Court has stated in another case that the business judgment of directors does not mean that directors can choose not to follow the rules contained in the *Securities Act*.[85]

But what does it mean to ensure that shareholders' interests are protected in the context of a bid? One could argue that once shareholders approve a poison pill, they have entrusted the board to defend them against a bid. This is a valid argument and certainly wagers in favour of allowing poison pills at least for a time-limited period. But poison pills that have not been approved by shareholders enable incumbent management and the board to thwart a bid that shareholders may wish to succeed. It is not clear that board decision making is the best mechanism to protect shareholders' interests in this specific context.

---

[84] See *BCE*, *supra* note 17 at paras 37–38. Citing *Peoples*, *supra* note 20, the Court continues on this point:

> In *Peoples Department Stores*, this Court found that although directors *must* consider the best interests of the corporation, it may also be appropriate, although *not mandatory*, to consider the impact of corporate decisions on shareholders or particular groups of stakeholders. As stated by Major and Deschamps JJ., at para 42: "We accept as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, *inter alia*, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment" (*BCE*, *supra* note 17 at para 39 [emphasis in original]).

[85] See *Kerr v Danier Leather Inc*, 2007 SCC 44, [2007] 3 SCR 331 where the Supreme Court focused not on takeover bids but on disclosure rules contained in the *OSA*, in the context of an initial public offering. Note that there is unresolved conflict between the role of securities commissions and the corporate law duty for the board to take into account the interests of other stakeholders in determining the corporation's best interests.

One might further argue that the board has a fiduciary duty to act in the best interests of the corporation and that shareholders are apathetic; they may vote when given the opportunity or they may simply "free-ride" by relying on sophisticated shareholders' decision making.[86] And, the argument may run, even if shareholders are not apathetic and ultimately disapprove of the direction in which the board takes the corporation, they have options under the corporate statute.[87] For example, shareholders elect directors annually. They could re-elect or refuse to re-elect those same directors; they are not bound to retain and endorse the current board. If an election is not in the offing, then shareholders have other legislative tools stipulated in the corporate statute at their disposal. They could launch a shareholder proposal,[88] requisition a meeting,[89] bring an oppression remedy claim,[90] or launch a derivative action.[91]

While thoughtful, these arguments fail to distinguish a takeover bid from the ordinary course of a corporation's business. As a change of control, a takeover bid means that the employment and roles of management and the board are potentially at stake. By contrast, a duty to act in the best interests of the corporation in terms of deciding whether to raise capital or change the name of the corporation, to take two examples, would not impact these individuals in such a direct and significant way. And, while shareholders elect directors, it is not necessarily the case that directors will act in their interests when the corporation is faced with a change of control.

Furthermore, corporate electoral machinery arguably does not provide shareholders meaningful participation in the proxy process; they do not control the nomination process and majority voting is only recently mandatory for TSX-listed issuers.[92] Even if shareholder voting were meaningful in this instance, shareholders would have to wait until the next annual meeting to exercise their vote or bear the expense of a dissident proxy process, which has been a successful tactic of late for only the wealthiest

---

86 Bernard S Black, "Shareholder Passivity Reexamined" (1990) 89:3 Mich L Rev 520 at 526–29.

87 See CSA Proposal, *supra* note 5 at 21.

88 See *CBCA*, *supra* note 10, s 103(5).

89 See *ibid*, s 143(1).

90 See *ibid*, s 241.

91 See *ibid*, s 239(1).

92 Recent TSX Amendments mean that, for TSX-listed issuers, which of course do not include companies listed on the TSX Venture Exchange, each director (other than a listed issuer) that is majority controlled must be elected by a majority of votes cast (see *Amendments to Part IV of the Toronto Stock Exchange ("TSX") Company Manual*, OSC Notice of Approval, (2014) 37 OSCB 1769).

of shareholders.[93] Finally, a successful oppression remedy claim means little in terms of altering a rejected change of control, especially if the bidder's offer has long expired. Courts may grant compensation to an aggrieved shareholder, but they will likely not reverse a board's decision to forgo a takeover bid.[94]

If boards are permitted to keep poison pills in place indefinitely, shareholder interests may be, but are not necessarily, protected. Rather, shareholders' fates are subject to the discretion of the board, which, as discussed above, may or may not act in their interests.[95] Indeed, the lesson from *BCE* is that boards are not *obliged* to act in shareholders' best interests. Rather, they may act in the interests of other stakeholders. There is a gap—conspicuous in the takeover bid context—that corporate law does not fill. In short, the fact that shareholders can elect directors is insufficient to remedy the lost opportunity to tender to a bid.

As discussed in Part II above, while securities regulators have jurisdiction to regulate in the area of defensive tactics, they are somewhat ineffective, at least under current law, when they exercise wide discretion as to whether a pill must go. The way in which securities regulatory authorities in Canada have exercised their collective discretion has left shareholders, target boards, and bidders subject to uncertainty in terms of likely outcomes; none of these parties knows at any point prior to a regu-

---

93 Note, for example, the proxy processes of Hess, Allergan, and Agrium. See "Elliott and Hess Trade Tit for Tat Ahead of Proxy Showdown", *Forbes* (13 May 2013), online: <www.forbes.com/sites/christopherhelman/2013/05/13/two-sides-spar-ahead-of-hess-corp-annual-meeting/>; Liz Hoffman, "Proxy Firm ISS Urges Shareholder Vote at Allergan", *The Wall Street Journal* (1 October 2014), online: <www.wsj.com/articles/proxy-firm-iss-urges-shareholder-vote-at-allergan-1412175544>.

94 See Stephanie Ben-Ishai & Poonam Puri, "The Canadian Oppression Remedy Judicially Considered: 1995-2001" (2004) 30:1 Queen's LJ 79 at 106–107, 113.

95 If it is the case that management seeks to entrench itself, then it stands to reason that there would be fewer takeover bids in jurisdictions in which boards are entitled to "just say no." Specifically, if takeovers were significantly easier to complete in Canada, the proportion of successful bids per corporation should be significantly higher in Canada than in the United States. To test this hypothesis, I compared the proportions of successful takeover bids in Canada and the United States to the numbers of registered corporations in each country (the data included corporations with at least $1 billion in market capitalization and were involved in a takeover bid registered in the Capital IQ database over the past ten years). I found that Canada experienced 17.8% more successful takeover bids per corporation than the United States, though Canada and the United States had no significant difference in the proportion of successful bids relative to total bids (at a 0.1 confidence level). This suggests that while Canada has more total takeover bids, the bids are not any more likely to be successful than in the United States.

latory decision whether a pill will be cease traded.[96] In some cases, securities commissions have acceded to the board's discretion in this area while in others they have not, and the reasons for decisions either way seem inconsistent.

The law—any law—should be certain for citizens to follow; the rule of law demands no less.[97] This point applies more broadly to the public interest power that securities regulators wield. As argued elsewhere,[98] the power is a broad administrative power that allows securities regulators to make orders that are in the public interest, including cease trade orders. The leading case of *Re Canadian Tire Corp.* stands for the principle that no breach of black letter law is necessary in order for securities regulators to find that the public interest has been violated.[99] This decision, and the case law (some of which is discussed above) that has emanated from it, gives rise to uncertainty.[100] The term "public interest" is not defined and securities regulators have broad leeway to decide whether the public interest has been violated.

B. CSA Proposal

The CSA Proposal, dubbed "50-10-120", seeks to strike a certain balance between the interests of target shareholders and the target board. Under the proposal, bids would be subject to a mandatory (i.e., unwaivable) minimum tender condition of more than fifty per cent of all outstanding target securities of the class subject to the bid, excluding those held by the bidder and its joint actors. Provided that all other terms and conditions of the bid have been complied with or waived, shareholders will also have an additional ten days to submit their shares after the minimum fifty per cent voting support requirement is met, in order to ensure that everyone has an opportunity to respond and to prevent those who did

---

96 The decisions in *Neo*, *supra* note 4, *Pulse Data*, *supra* note 4, and *Fibrek*, *supra* note 67, discussed above, are key examples of the differing approaches to adjudicating poison pills. As Adrian Myers states, "regulators, not shareholders, are the ones who determine whether a hostile takeover succeeds or fails. By forcing companies to abandon takeover defences after arbitrary periods of time, regulators leave shareholders vulnerable not just to hostile bidders but to unexpected turns of fate" (*supra* note 74).

97 The importance of clear and consistent laws is discussed in Lon Fuller, *The Morality of Law* (Yale University Press, 1964). Fuller argues: "Certainly there can be no rational ground for asserting that a man can have a moral obligation to obey a legal rule that does not exist, or is kept secret from him, or that came into existence only after he had acted, or was unintelligible, or was contradicted by another rule of the same system, or commanded the impossible, or changed every minute" (*ibid* at 39).

98 See Anand, "*Magna*", *supra* note 81.

99 (1987), 10 OSCB 857, 35 BLR 56, aff'd (1987), 59 OR (2d) 79, 37 DLR (4th) 94 (SC).

100 See Anand, "Carving the Public Interest", *supra* note 59.

not tender from being left as minority shareholders with no opportunity to sell later.[101] Bids would therefore only succeed with the support of a majority of independent shareholders. In essence, the bidder must obtain a majority of minority approval before it can take up shares. Unless the target board prefers a shorter period—but in any event not less than 35 days—bids must remain open for a minimum of 120 days.

The fifty per cent minimum tender condition is consistent with the arguments above as it weighs in favour of shareholder decision making. The underlying rationale is that in a hostile bid, "each shareholder must ultimately be given access to an offer and the opportunity to tender."[102] Akin to a shareholder vote, this approach allows a majority of shareholders the ability to determine whether the takeover bid will succeed. Minority shareholders who wish to tender, but whose views deviate from the majority who do not tender, will not have their shares taken up pursuant to the bid. In an era where shareholders are increasingly sophisticated,[103] it makes sense to allow bidders to "speak to" target shareholders directly—especially in the case of poison pills that are not approved by shareholders.

To be sure, the board continues to have a role in this process; it prepares and distributes a directors' circular, evaluates the bid, and makes a recommendation to shareholders that the latter can choose to follow or ignore.[104] In this instance, the directors' role gravitates toward being advisory in nature, rather than one that usurps a decision that should fall to shareholders as owners of the securities. This approach is not identical to, but reaches a similar result as, the US case law. US law holds that in a takeover bid, the directors' role shifts from being the stewards of the company to one that must achieve the highest price for shareholders.[105] In the United States, when a corporation is subject to a takeover bid, shareholders' interests explicitly trump all other concerns when the board discharges its duties. In Canada, under the CSA Proposal, shareholders' interests

---

[101] See Janet McFarland, "Regulators Unveil New Rules for Takeover Bids", *The Globe and Mail* (31 March 2015), online: <www.theglobeandmail.com/report-on-business/regulators-unveil-new-rules-for-takeover-bids/article23708641/>.

[102] James C Tory, Kevin Morris & John Emanoilidis, "Canadian Securities Regulators' Decisions on Poison Pills Diverge" (30 July 2010), online: Torys <www.torys.com/Publications/Documents/Publication%20PDFs/MA2010-4.pdf>.

[103] See Jeffrey MacIntosh, "The Role of Institutional and Retail Investors in Canadian Capital Markets" (1993) 31:2 Osgoode Hall LJ 371 at 377–87.

[104] See current law contained in Part XX of the *OSA*, *supra* note 1, ss 95(1)–(2).

[105] These are the so-called "*Revlon* duties" pursuant to which directors in a sale of control shift from being "defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company" (*Revlon*, *supra* note 38 at para 12).

are also of primary importance as they (or a majority of shareholders) decide the fate of the corporation in which they have invested.

The minimum tender condition will "prevent bidders from being able to corner target shareholders into the undesirable choice of selling into an underpriced offer or being stuck with illiquid shares."[106] While this aspect of the CSA Proposal is laudable, the 120-day bid period is ill conceived. The rationale for the 120-day rule is "to provide offeree boards with a longer, fixed period of time to consider and respond to a take-over bid."[107] But hostile bidders will likely feel exposed under the 120-day period since their bid remains open and a white knight can come forward during this time.[108] Further, the bidder's financing will likely be riskier and more expensive; financial resources that bidders have allocated to purchase the target's shares remain in limbo (i.e., unusable) while the 120-day clock ticks.

The 120-day bid period will, as a result, deter bids (and certainly hostile bids) from occurring, which is not optimal from an economic efficiency standpoint. As argued above, takeover bids improve returns that accrue to shareholders individually as well as the performance of the overall economy.[109] It is true that the target board can reduce the 120-day period as it might in a friendly transaction. If it does, the bid must remain open for a minimum of thirty-five days and all bids would be subject to the same period.[110] But the argument here is that thirty-five days should be the ceiling, not the floor, in terms of the time during which the target board has to act. The justification for such a lengthy bid period, including the negative implications for target shareholders, bidders, and takeover bids generally, has not been made in the CSA Proposal.

If implemented, the CSA Proposal means that specific requirements relating to majority approval and bid periods will govern takeover bids. The law will, therefore, be more certain and will lead to less poison pill litigation. In this way, the CSA Proposal is, generally, an improvement on the law that it would leave behind. The downside is that instead of relying

---

[106] Anita Anand, "New Canadian Securities Administrators Rules Would Discourage Takeovers", *Financial Post* (1 April 2015), online: <business.financialpost.com/fp-comment/new-csa-rules-would-discourage-takeovers>.

[107] CSA Proposal, *supra* note 5 at 3.

[108] As MacIntosh states in "A Reply", *supra* note 48 at 332: "The mandatory minimum offer period allows other prospective acquirors time to formulate a competing offer, driving up the acquisition price and reducing the gains to the initial bidder. It also allowed self-interested management ... time to formulate a defensive response that will either defeat a hostile bid or generate a much higher acquisition price."

[109] See text accompanying note 15.

[110] See CSA Proposal, *supra* note 5 at 3.

on poison pills, target boards may more readily implement other defensive tactics (asset sales or private placements, for example) as they will have a lengthy period of 120 days in which to do so. It seems plausible that regulatory intervention may occur as a result of tactics *other than* poison pills. Furthermore, nothing seems to prohibit target boards from implementing tactical pills prior to the expiry of the 120-day bid period. With no national securities regulator in place, it is possible that individual jurisdictions will address tactical pills differently and the fragmentation that has plagued the takeover bid regime in the past will continue.

Finally, the CSA Proposal also contains an additional disclosure obligation for target boards called a "deposit period news release" which is issued by the target in response to a "proposed or commenced" takeover bid.[111] The question that arises is why this additional disclosure obligation is required, given the obligation on issuers to disclose material changes.[112] It is possible that the CSA sought to establish a particular date on which the reduced time period would be triggered. While it is clear that issuers are not well served on a cost-benefit basis by this requirement (especially in terms of enhanced compliance costs), one might legitimately ask whether investors are better served by an additional disclosure obligation. There are likely other less costly possibilities including allowing a waiver of the 120-day period.

The CSA Proposal is, like many legislative initiatives, a product of compromise amongst provincial securities commissions that have held differing views on the rules relating to takeover bids for decades.[113] While compromise is laudable, it does not always lead to policy that fulfills the relevant legislative mandate. Such is the case here: on the one hand, the 50-10 aspect of the CSA Proposal is important from an investor protection standpoint. On the other hand, the 120-day proposal is a marked shift away from the 35-day period under current law. One asks how regulators came to decide that the legally-mandated bid period is too short. In short, it is difficult to draw the line in the sand; establishing the appropriate time period for bids to remain open is in some sense necessarily discretionary. But 120 days seems too far removed from current law and practice, placing bidders in a precarious position if they even choose to make a bid in the first instance.

---

[111] See *ibid* at 7.

[112] See disclosure obligations applicable to all issuers in *National Instrument 51-502 Continuous Disclosure Obligations*, OSC NI 51-102, (2004) 27 OSCB 3439 at 3458–59.

[113] This compromise is evident in the CSA Proposal, *supra* note 5 itself, and especially in the background discussion of the AMF Report, *supra* note 8 at 3–8.

Conclusion

Poison pills, especially those adopted without shareholder approval, isolate shareholders during a crucial decision about the firm in which they have invested. As long as the potential for agency costs in the takeover bid context exist, shareholders should be able to decide the fate of their investment. The fifty per cent condition is commendable as it minimizes the impact of potential conflicts of interest at the board and senior management level. A 120-day bid period, however, is too long: it disadvantages both target shareholders and bidders by making bids more expensive while benefitting the board and management of the target. A 120-day bid period will ultimately serve to deter takeover bids from occurring. Given the market discipline and capital allocation efficiency benefits derived from takeover bids, it is counterintuitive for securities commissions to craft takeover bid rules that have the effect of discouraging bids. Surely a solution that better fulfills the overall objectives of securities regulation can be found.