HARD TO SWALLOW: THE CANADIAN POISON PILL FROM AN AMERICAN PERSPECTIVE

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I. INTRODUCTION

In this paper, I examine the Canadian system of regulation of corporate takeover defenses with reference to the American system. This comparison involves: *first*, an investigation and survey of the structure of Canadian securities law; *second*, an analysis of Canada's jurisprudence surrounding takeover defenses and its underlying philosophy of regulation; and *third*, a proposal to modify the Canadian system based on a brief analysis of the American system. This article proposes that Canada should place more trust in the shareholder franchise and should limit the ability of its regulators to interfere with a board's exercise of its fiduciary duties in a takeover situation.

Canada's business corporation statutes protect shareholders much more effectively than their U.S. equivalents do. As a result, shareholders can better discipline their agents when those agents do not adequately serve their interests. These statutory protections complement Canada's well-developed body of corporate common law governing the fiduciary duties of directors in takeover situations and otherwise. Directors' fiduciary duties require them to take certain considerations into account in takeover situations; where directors fail to fulfill their fiduciary duties, shareholders can discipline them in court.

However, directors currently receive conflicting directives from Canadian courts and Canadian securities commissions. Securities commissions are empowered to intervene in takeover bids to impose duties of their own devise on directors. These securities law duties reflect different priorities than those articulated by courts holding on matters of common law fiduciary duty. This conflict creates confusion that is undesirable and untenable.

Instead, Canada should adopt a more hands-off regulatory climate with regard to boards in takeover situations. Canada should trust in the application of well-established control mechanisms—specifically, the shareholder franchise and fiduciary duties as interpreted by Canadian courts and prosecuted by shareholders—to constrain the board while respecting its important management role according to traditional corporation theory.

II. ANALYSIS

1. Structural Overview of Canada's System of Securities Regulation

a. Introduction: Goals of the System

The purpose of the Canadian regulatory system is to protect investors and to promote efficiency in the capital markets. Specifically, the system's objective is "to protect investors from fraudulent, manipulative or misleading practices," "to ensure investors have fair access to market facilities and market or price information," and "to reduce the risk of failure of market intermediaries and when it cannot be avoided. . .seek to reduce the impact on investors and other market participants."[1] These goals are reflected in the statutes that form the basis for Canada's securities law.[2]

But these goals are compromised by the structure of the regulatory system. As a matter of Canadian constitutional law, the ten provinces and three territories historically have been accorded independent authority over securities regulation under the provincial "property and civil rights" power.[3] And, unlike in the U.S., each securities commission has direct and substantive jurisdiction over boards in takeover situations in addition to the jurisdiction traditionally exercised by common law courts. This fragmented and disjointed regulatory system has led to

1 William S. Rice, *Introduction to the Canadian Securities Administrators*, CANADIAN SECURITIES ADMINISTRATORS, (Mar. 3, 2010), *available at* http://www.securities-administrators.ca/our-mission.aspx.

2 *See, e.g.*, Securities Act (Ontario), R.S.O. 1990, ch. S.5 ("OSA"), § 1.1 (Can.).

3 Lymburn v. Mayland, [1932] 1 W.W.R. 578 Olms. (Can.).

confusion regarding basic securities law policy—*both* as between jurisdictions *and* among market participants. As between jurisdictions, it allows for divergence in application of supposedly national policies that causes uncertainty in Canada's capital markets. For market participants, it creates an environment of potentially conflicting directives from the judicial branch and the administrative branch.

b. A Fragmented System

i. Securities law defined, jurisdiction by jurisdiction

Securities regulation in Canada is an American federalist's dream come true. Unlike in the U.S., Canada does not have a securities regulatory authority at the federal government level. There is no Canadian equivalent of the SEC, and the Supreme Court of Canada (the "SCC") recently held that such a national regulator would be unconstitutional.[4] Instead, each of Canada's thirteen jurisdictions has its own securities commission constituted by a separate enabling statute, that province's Securities Act. The body of securities law in each province consists of (*i*) the Act, (*ii*) the legally binding rules and regulations promulgated by the commissions under that Act, and (*iii*) nonbinding policies including the decisions of the commissions interpreting the statute and the rules and regulations with respect to a particular person or company.[5] Provincial securities commissions are responsible for monitoring and enforcing the standards imposed on registrants by securities law so defined and by stock exchange rules (if one exists in the province).[6] But unlike the SEC, Canadian securities commissions' purview includes enforcement of certain substantive policies that in the American system would be governed by state corporate law, such as the regulation of takeover defences. In other words, securities law in Canada governs more than mere disclosure obligations: a Canadian securities commission also will initiate an enforcement action with regard to an issuer based on the broad and ambiguous "public interest jurisdiction" that each of Canada's securities statutes grants to its securities commission.[7]

[4] Reference re Securities Act, [2011] SCC 66 (Can.), *available at* http://scc.lexum.org/en/2011/2011scc66/2011scc66.html .

[5] OSA § 1(1) ("Ontario securities law") (Can.).

[6] BORDEN LADNER GERVAIS LLP, SEC. LAW & PRACTICE §INT 9.1 — Purposes of the Act (3d ed. 2011).

[7] *See, e.g.*, OSA § 127(1) (Can.) ("The Commission may make one or more of the

Enforcement decisions may be rendered after an administrative hearing before a commission. Parties to the hearing then may appeal the commission's decision to that province's or territory's trial court[8] or court of appeal.[9] The commissions are bound by the orders of the judicial courts specified in the statute,[10] but are not bound by the decisions of other securities commissions or even their own decisions.[11] These enforcement proceedings produce bodies of prior decisions in each province equivalent to policy statements by an administrative agency in the United States: the prior decisions of a given provincial securities commission guide but do not bind that commission (or any other). As a practical matter, the securities regulators interpret precedent—their own and that of other provinces—much as state courts would interpret case law. However, while Ontario and British Columbia generally are considered the leading jurisdictions in terms of securities law, there is not the same level of convergence as that which has occurred around Delaware law in the United States.[12]

This jurisdiction-by-jurisdiction autonomy also extends to enforcement of the securities laws, substantive and otherwise. The thirteen securities commissions each have different powers and sanctions, and different levels of resources to devote to the various regulatory tasks that they are charged with. Accordingly, "[e]nforcement varies from jurisdiction to jurisdiction."[13] Moreover, the fragmented multi-party nature of the system makes investigation of securities law violations in multiple jurisdictions inherently more difficult. Coordination of such complex investigations is procedurally challenging, and there is less direct accountability and therefore less inclination and political capital for any one jurisdiction to expend

following orders *if in its opinion it is in the public interest to make the order or orders* . . . .")(emphasis added).

8 *See, e.g.*, OSA § 9(1).

9 *See, e.g.*, Securities Act (British Columbia), R.S.B.C. 1996, ch. 418 ("BCSA"), § 167 (Can.); Securities Act (Saskatchewan), S.S. 1988-89, ch. S–42.2, § 11(1) (Can.).

10 *See, e.g.*, OSA § 61(8).

11 *See, e.g.*, BCSA § 167.5(1) ("Subject to the regulations, the commission *may*, by order, adopt or incorporate by reference all or any provisions of any extraprovincial securities laws . . . .") (emphasis added).

12 *Cf.* ANDREW KITCHING, SECURITIES REGULATION: CALLS FOR A SINGLE REGULATOR 8, PRB 08–38E (Library of Parliament (Can.), (Feb. 16, 2009), *available at* http://www2.parl.gc.ca/content/lop/researchpublications/prb0838-e.htm .

13 *Id.* at 9.

resources that would benefit other jurisdictions.[14]

ii. Stock exchanges

Regulatory oversight of Canada's capital markets is equally balkanised. A different regulator oversees each of Canada's three main stock exchanges.[15] The Ontario Securities Commission ("OSC") is the lead regulator for the Toronto Stock Exchange, Canada's senior equity market and its largest and most active stock exchange.[16] The Alberta Securities Commission ("ASC") and the British Columbia Securities Commission ("BCSC") jointly are the lead regulators for the TSX Venture Exchange, a public venture capital marketplace for emerging companies.[17] Quebec's Autorité des marchés financiers is the lead regulator for the Bourse de Montréal, Canada's derivatives exchange that trades futures contracts and options on equities, indices, currencies, exchange-traded funds, energy, and interest rates.[18] These three exchanges all are owned by TMX Group, Inc., located in Toronto, Ontario.[19]

Piecemeal regulation of these three arms of a single entity (TMX Group, Inc.) has several negative consequences. First, the system faces obvious economies of scope that could be realised by consolidating basic common administrative functions. Failure to realise these economies of scope necessarily increases transaction costs for all parties involved. Second, regulation by multiple smaller and more local regulators increases the vulnerability of the regulatory system to capture by special interests. Factions potentially can affect a disproportionate

[14] *Cf.* Stephan P. Sonnenberg, Lecturer on Law, Harvard Law School, Lecture to Negotiation Workshop B1 at Harvard Law School: Multiparty Negotiations (Mar. 3, 2011); *see also* Kitching, *supra* note 12, at 9.

[15] Rice, *supra* note 1.

[16] "OSC | Marketplaces, SROs & Clearing Agencies – Exchanges", Ontario Securities Commission, *available at* http://www.osc.gov.on.ca/en/Marketplaces_exchanges_index.htm (last accessed March 23, 2012); "OSC | Marketplaces, SROs & Clearing Agencies – Exchanges – TMX Group Inc. and TSX Inc.", Ontario Securities Commission, *available at* http://www.osc.gov.on.ca/en/Marketplaces_tmx-tsx_index.htm (last accessed March 23, 2012).

[17] "About ASC", Alberta Securities Commission, *available at* http://www.albertasecurities.com/about/Pages/default.aspx (last accessed March 23, 2012).

[18] "Montréal Exchange | Regulation", TMX Inc., http://reg.m-x.ca/en/about/mission_roles ("Under the AMF oversight…") (last accessed March 23, 2012).

[19] *TMX Group Inc. Corporate Profile*, TMX Group Inc. (2010), *available at* http://www.tmx.com/en/pdf/TMXGroupCorporateProfile.pdf.

influence over the regulatory policy applicable to their exchange. And third, oversight by multiple regulators reduces the efficiency with which the overall system manages systemic risk. Diffuse loci of regulation means that systemic risk associated with the individual stock exchanges could in the aggregate be sufficient to bring down the nation's capital markets. Moreover, it might be more socially or economically optimal to allow a certain overall level of systemic risk, allocation of which could be better determined by a single regulator rather than by multiple regulators each of whom might over- or under-regulate in the aggregate.

c. Attempts at Unity

Canada's securities commissions have taken some steps to mitigate this regulatory cacophony. For one, each commission delegates certain regulatory responsibilities, including with regard to Canada's exchanges, to self-regulatory organizations with national scope, such as the Investment Industry Regulatory Organization of Canada and the Mutual Fund Dealers Association.[20] But more importantly, in 2003, Canada's provincial and territorial securities commissions formally organized into the Canadian Securities Administrators ("CSA"), a voluntary umbrella organization.[21] The CSA's stated objective is "to improve, coordinate and harmonize regulation of the Canadian capital markets."[22] This attempt at harmony through the CSA has taken two principal forms: (*i*) *practical reciprocity*–based, by means of the "passport system," and (*ii*) *regulatory coordination*–based, by means of adoption of common rules and regulations. However, the attempts are largely ineffective in achieving true regulatory harmony. As a practical matter, the problem with voluntary cooperation is that any ostensibly national policy can be undone any time a CSA member province unilaterally changes its policy.

[20] BORDEN LADNER GERVAIS LLP, SEC. LAW & PRACTICE §INT 9.1 — Purposes of the Act (3d ed. 2011).

[21] "Provincial securities regulators have been getting together for a number of years. [Their] first meetings can be traced back to the beginning of the 1930s. The CSA was re-structured in September 2003 into a more formal organization." E-mail from CSA Secretariat to Ian Wildgoose Brown (Apr. 13, 2011)) (on file with author).

[22] Rice, *supra* note 1, at 5.

i. Practical reciprocity–based collaboration

Under the passport system, a market participant's registration with one commission effectively is given full faith and credit by commissions in the other participating jurisdictions. For example, the Nova Scotia Securities Commission will consider an issuer who successfully registers with the Saskatchewan Securities Commission to be registered under Nova Scotia securities law. The program's intention is to allow market participants to have access to markets in all Canadian jurisdictions but deal only with their principal regulator.[23]

However, "most stakeholders" (apart from the CSA itself) feel that the application of the passport system "is limited and it still falls short of what is required in today's global marketplace."[24] The program is voluntary, and Ontario (Canada's most populous province and home to Toronto, its largest economic hub) is not a participating jurisdiction.[25] Some market participants believe that the passport system, which requires virtual unanimity among provinces and territories, is "[too] slow to respond to new policy requirements as they arise."[26] Moreover, "a company wishing to raise money across Canada still may be required to pay fees to 13 jurisdictions,"[27] and be required to continue dealing with thirteen separate bureaucracies. These hurdles impose transaction costs on market participants trying to invest in Canada's capital markets and potential systemic risk management issues on the capital markets as a whole.

[23] *Id.* at 7; *see also Regulatory Cooperation – Pan-Canadian*, CANADIAN SECURITIES ADMINISTRATORS, http://www.securities-administrators.ca/aboutcsa.aspx?id=96 (last visited Apr. 11, 2011).

[24] FINAL REPORT AND RECOMMENDATIONS FROM THE HON. THOMAS HOCKIN, P.C. ET AL., EXPERT PANEL ON SECURITIES REGULATION, TO THE HON. JIM FLAHERTY, P.C., M.P., MINISTER OF FINANCE (CAN.) at 2 (Jan. 12, 2009) ("Final Report"), *available at* www.expertpanel.ca.

[25] Rice, *supra* note 1, at 7. Instead, the OSC makes its own decisions taking into consideration the decision of the applicant's principal regulator. All other Canadian jurisdictions treat OSC decisions as definitive as though governed by the passport system.

[26] Kitching, *supra* note 12, at 8.

[27] *Id.* at 7 (quoting Gowling Lafleur Henderson LLP, *Singing the Passport Blues: Perfect Harmony Eludes Provincial Securities Harmonization Efforts*, 4 MARKETCAPS @ GOWLINGS (Mar. 14, 2008)).

ii. Regulatory coordination–based collaboration.

The CSA also acts as a forum for coordinating regulatory collaboration among Canada's thirteen securities regulators.[28] This collaboration ultimately takes the form of instruments and policies governing *both* technical or procedural *and* substantive aspects of securities law. The instruments and policies are adopted *either* nationally (i.e., by all securities commissions) *or* multilaterally (i.e., by multiple but not all securities commissions).[29] Instruments are adopted as rules by participating securities commissions; a given instrument, therefore, has the force of law in each jurisdiction that adopts it.[30] Policies are adopted as "guidelines" for market participants regarding a securities commission's "perspective" on the subject of the policy; a given policy informs the commission's enforcement of securities laws in its jurisdiction.[31]

CSA members' staff draft *both* instruments *and* policies collaboratively, but each proposed instrument or policy must pass a notice and comment period in each jurisdiction.[32] Each then must be approved separately by each minister responsible for overseeing administration of his jurisdiction's securities law.[33] This problem is compounded by the fact that thirteen securities commissions then independently interpret, apply, and enforce each supposedly national component of the system.

The nature of this regulatory collaboration based process has two negative effects. First, similar to the passport program, its voluntary nature creates opportunities for individual jurisdictions to except themselves from a given instrument or policy. The result is an institutionalized acceptance of disparate regulation and standards across the country. Second, its decentralized nature slows the adoption of national rules and policies. The potential for delays seriously inhibits

[28] *Cf. Securities Law & Instruments – Instruments, Rules & Policies*, ONTARIO SECURITIES COMMISSION, http://osc.gov.on.ca/en/SecuritiesLaw_irps_index.htm (last visited Apr. 11, 20011).

[29] *See, e.g.*, *Notice of National Policy 62-202 and Rescission of National Policy Statement No. 38: Take-Over Bids – Defensive Tactics*, ONTARIO SECURITIES COMMISSION, (effective Aug. 4, 1997), http://osc.gov.on.ca/en/SecuritiesLaw_pol_19970704_62-202_fnp.jsp (last visited Apr. 11, 2011).

[30] Telephone Interview with an Enquiries Officer, OSC (Mar. 2, 2011).

[31] *Id*.

[32] *Id*.

[33] *Id*.

efficient regulation of Canada's capital markets.[34] According to an expert panel convened in 2009 by the federal government ("Expert Panel"), Canada's system is "too slow, too cumbersome, and too expensive."[35] The Expert Panel pointed out that "[a]t a time when speed counts, policy development is protracted, negatively affecting Canada's ability to respond in a timely manner to national and global developments."[36]

iii. Underlying tensions

A fragmented system with a voluntary umbrella organization like the CSA makes securities regulation a chip in a larger federal-system negotiation game. The multi-party nature of the system stifles efficient substantive negotiation.[37] It increases transaction costs associated with passing multijurisdictional instruments and policies. Additionally, the multi-party nature allows each province's political system to have a separate voice and an effective veto on any unified national policy, rendering negotiation multidimensional and therefore more difficult.

In general, where "there's an audience behind [the negotiator] . . . value-creation [becomes] harder."[38] In the context of Canada's federal government structure, where each party must answer to its own home jurisdiction, a comingling of securities regulation and federal politics allows federation-related concerns unrelated to securities law to seep into negotiations regarding even the relatively apolitical aspects of the system. "Longstanding disputes" can poison the negotiating atmosphere.[39] In the Canadian context, any agreement must be struck in the shadow of other inter-jurisdictional federal politics. As a result, "principled options generation becomes more risky", and "it is more difficult to resolve even simple issues."[40] These concerns compound the

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[34] *Id.* (describing adoption of National Instrument 31-103, proposed in Feb. 2007 and adopted in Sept. 2009 only after two notice and comment rounds).

[35] FINAL REPORT AND RECOMMENDATIONS FROM THE HON. THOMAS HOCKIN, P.C. ET AL., EXPERT PANEL ON SECURITIES REGULATION, TO THE HON. JIM FLAHERTY, P.C., M.P., MINISTER OF FINANCE (CAN.) at 2 (2009) ("Final Report"), *available at* www.expertpanel.ca.

[36] *Id*.

[37] The following discussion is based on Stephan P. Sonnenberg, Lecturer on Law, Harvard Law School, Lecture to Negotiation Workshop B1 at Harvard Law School: Multiparty Negotiations (Mar. 3, 2011).

[38] *Id*.

[39] *Id*.

[40] *Id*.

problems that plague the attempts to forge regulatory unity on an ad hoc basis described above.

d. National Securities Regulator

Canada's securities system has withstood many bouts of advocacy for a national securities regulator.[41] Commentators and commissions repeatedly have asserted that a common securities regulator is "the only way of promoting timely enforcement of securities laws and eliminating overlap and confusion" among Canada's jurisdictions.[42] The federal government acted on this succession of expert opinions and drafted a national *Securities Act* in 2010. On April 13 and 14, 2011, the SCC heard arguments on the constitutionality of the Act.[43] This legislative activity marked a strong move toward a national securities regulator, a move that could have begun to address the jurisdictional conflicts and confusion that currently characterize Canadian securities law. However, as noted above, the SCC held in an advisory opinion that the Act was unconstitutional as drafted.[44]

A detailed consideration of the benefits of a national securities regulator is beyond the scope of this paper. However, and notwithstanding the opinion of the SCC, the arguments in favor of such a regulator seem to be grounded in market efficiency and protection of investors and other market participants, whereas the arguments against seem to be grounded in petty interprovincial politics and local economic entrenchment motives. Moreover, the continued regulatory fragmentation that the SCC decision leaves untouched has an insidious impact on the regulation of takeover defenses.

41 REPORT OF THE ROYAL COMMISSION ON BANKING AND FINANCE (the "Porter Commission Report") (1964); REPORT OF THE ATTORNEY GENERAL'S COMMITTEE ON SECURITIES LEGISLATION IN ONTARIO TO LEGISLATIVE ASSEMBLY (the "Kimber Report") (1965).

42 Kitching, *supra* note 12, at 9.; *see also* MICHAEL E.J. PHELPS, CHAIR, WISE PERSON'S COMMITTEE TO REVIEW THE STRUCTURE OF SECURITIES REGULATION IN CANADA, DEPT. OF FINANCE CANADA, IT'S TIME (Dec. 17, 2003), *available at* www.wise-averties.ca; CRAWFORD PANEL ON A SINGLE CANADIAN SECURITIES REGULATOR, MINISTRY OF GOVERNMENT SERVICES, BLUEPRINT FOR A CANADIAN SECURITIES COMMISSION: FINAL PAPER (2006), *available at* www.cba.ca/contents/files/misc/msc_crawfordreport_en.pdf.

43 Nigel Campbell & Doug McLeod, *Supreme Court Hears Arguments on National Securities Regulator*, 2011–04 LITIGATION & DISPUTE RESOLUTION BULLETIN 1 (Apr. 2011), *available at* http://www.blakes.com/english/view_bulletin.asp?ID=4711.

44 Reference re Securities Act, *supra* note 4.

2. Substantive Overview of Canada's Regulation of Takeover Defenses

Both the fragmented structure of Canada's securities law system *and* the active role that Canada's provincial securities commissions play in policing boards of directors in takeover situations contrast sharply with the American model of securities regulation. In the United States, securities law is governed federally by the SEC. The SEC's mandate under the Securities Act of 1933 (known as the "'33 Act") and the Securities Exchange Act of 1934 (known as the "'34 Act") is for the most part a regime based on disclosure.[45] The only truly substantive work that those Acts do is to protect against insider trading and short-swing profits.[46] It is the state courts that govern substantive corporate law including the law of takeover defenses.

The American system seems incoherent in a Canadian sense because the corporate law applicable in a given lawsuit depends on the implicated corporation's state of incorporation. Whatever court, state or federal, is presiding over a given case must apply that state's corporate law. For instance, Delaware follows the shareholder supremacy model outlined in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[47] but Pennsylvania ostensibly follows a "stakeholder" model that is even more explicit than that mandated by Canadian corporate law.[48]

However, the potential for incoherence in American corporate law is mitigated by two factors.[49] First, most corporations are based in Delaware, and so most corporate law–related suits are brought in Delaware. This convergence on Delaware is based both on inertia (holdover from the regulatory "race to the bottom" of the nineteenth century) and on a regard for a state court judiciary generally considered expert in corporate law matters. Second, Wall Street essentially defaults

[45] Michael Wiseman, Sullivan & Cromwell LLP, Presentation at the Harvard Business Law Review Symposium (Apr. 2, 2011).

[46] *See, e.g.*, 15 U.S.C. § 78p(b) (1934) (known as § 16(b) of the '34 Act) and 17 C.F.R. § 240.10b-5 (1951).

[47] 506 A.2d 173 (Del. 1986). The shareholder supremacy model's supremacy is debatable in light of subsequent Delaware jurisprudence.

[48] 15 PA. CONS. STAT. ANN. § 1715 ("Exercise of powers generally") (1995); *see* Re BCE Inc., [2008] 3 S.C.R. 560 (Can.) (articulating a strong stakeholder model of fiduciary duties for Canadian boards of directors; discussed *infra*).

[49] Mark Gordon, Wachtell Lipton Rosen & Katz LLP, Lecture to the Mergers & Acquisitions Workshop at Harvard Law School: Deal Protection and Topping Bids (Jan. 10, 2011).

to a Delaware law standard in assessing any board's actions regardless of the individual corporation's state of incorporation. This decision seems to be based similarly on inertia, given Wall Street's familiarity with Delaware law. As a result, directors typically follow the Delaware "shareholders first" jurisprudence for reputational reasons: directors want to be selected as directors of other companies in the future, and Wall Street's judgment has enormous influence—both explicit and implicit—in those determinations.

This level of de facto unity does not exist to the same extent in Canada. Though Toronto unequivocally is Canada's business capital, companies are incorporated across Canada and decisions by any securities commission can affect the country's business landscape. Although Canadian courts have built a robust body of corporate law to inform directors' decisions regarding the corporation that shareholders entrust to them, Canada's securities commissions arrogate to themselves decisions regarding the manner in which directors fulfill their fiduciary duties in practice. As discussed below, variation across jurisdiction at the edges of takeover defense jurisprudence, and potential conflict between substantive corporate law and substantive securities law, causes uncertainty and tension that is inefficient and undesirable.

At a broader level, despite better protection of the shareholder franchise, Canada is more restrictive of the board's use of takeover defenses such as a shareholder rights plan ("SRP"). This restrictive stance that Canadian securities law has allowed its securities commissions to adopt has two negative consequences. First, systemically undermining a board's ability to erect effective takeover defenses means that hostile takeovers in Canada are too easy. Given that a transaction of some kind almost inevitably occurs as soon as the first bid is made, more M&A activity occurs than is optimal. Second, undermining existing corporate law constraints on boards in the name of some version—one unitary vision—of shareholder interest undermines board management authority. This grant of authority to the board is the foundation of corporate common law. It should not be revoked lightly.

a. Introduction: Sources of Law

National Policy 62-202 – *Takeover Bids – Defensive Tactics* articulates the two principles that underlie Canadian securities law relating to takeover defenses.[50] First, Canada has determined that unrestricted auctions produce the most desirable results in takeover bid situations.[51] Second, Canada has determined that shareholders of the target of a hostile bid generally should be free to make a fully informed decision to determine the ultimate outcome of that bid.[52]

Regulation of takeover defenses by Canadian securities commissions historically has followed these two principles. Accordingly, the target's board may use defensive tactics (e.g., a SRP[53]) in a genuine attempt to obtain a better bid—i.e., to create an auction to improve the price that shareholders will receive for their shares. However, tactics that are likely *either* to deny *or* to severely limit the shareholders' ability to respond to a takeover bid prompt securities commissions to take *sua sponte* regulatory action against the target and its board, or to accept an application by the hostile bidder.[54] The regulatory action typical in such circumstances is a "cease-trade" order that freezes trading in shares of the target's stock (or rights issued pursuant to a SRP).[55]

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[50] National Policy 62-202, *Takeover Bids – Defensive Tactics*, SEC. POLICY 65648519006 (into force Aug. 4, 1997), *available at* http://www.osc.gov.on.ca/en/SecuritiesLaw_pol_19970704_62-202_fnp.jsp ("NP 62-202").

[51] NP 62-202, § 1.1(5).

[52] Re Canadian Jorex Ltd., [1992] 15 O.S.C. Bull. 257 (Can.), para. 16 ("[W]e have every confidence that the shareholders of a target company will ultimately be quite able to decide for themselves, with the benefit of the advice they receive from the target board and others, including their own advisers, whether or not to dispose of their shares and, if so, at what price and on what terms. And to us the public interest lies in allowing them to do just that."); *see also* David Surat & Paul A.D. Mingay, *OSC allows shareholder rights plan to stand*, INTERNATIONAL LAW OFFICE: CORPORATE FINANCE/M&A – CANADA, July 8, 2009, *available at* http://www.internationallawoffice.com/Newsletters/Detail.aspx?r=18930&redir=1.

[53] Ralph Shay, *In Alberta and Now Ontario: There Comes a Time When a Poison Pill Gets to Stay*, 2009–06 SECURITIES NEWSLETTER 1–2 (June 2009). When the SRP first arrived in Canada a few years after Martin Lipton invented it, securities commissions did not employ National Policy 38 (predecessor to NP 62-202) to restrict their adoption by Canadian companies.

[54] NP 62-202, § 1.1(2), (5), (6); *see also* BORDEN LADNER GERVAIS LLP, TAKE-OVER BIDS AND ISSUER BIDS: DEFENCES TO UNFRIENDLY TAKE-OVER BIDS: NATIONAL POLICY 62-202, SEC. LAW & PRACTICE § 20.23.2 (3d ed. 2011).

[55] Shay, *supra* note 54.

The commission's regulatory action is based on the broad and ambiguous "public interest jurisdiction" that each of Canada's securities statutes grants to its securities commission.[56] This jurisdiction effectively attaches at the commission's discretion, even where there has been no express violation of the securities laws.[57] In such cases, the commission applies the principles of the appropriate national policy, ostensibly always prioritising the interests of shareholders; in cases of potentially inappropriate takeover defenses, the commission looks to NP 62-202.[58] Commissions keep a close eye on situations where a target board uses a SRP—corporate law's most controversial takeover defense.[59]

b. Basic SRP Jurisprudence: Legal Framework

i. The OSC decides *Canadian Jorex*.

The OSC set the benchmark for treatment of the SRP in *Re Canadian Jorex Ltd.*, heard in December 1991. In its decision, the *Canadian Jorex* panel stated that:

> . . . the only question we really had to decide was whether the [SRP] had served its purpose in facilitating an auction for Jorex, and so ought to be discontinued as against the Mannville bid to let the shareholders decide which bid they preferred (if, indeed they wished to accept either one). All seemed to agree . . . that "there comes a time when the pill has got to go." The only real issue before us, then . . . was "when does the pill go."[60]

The *Canadian Jorex* panel thereby acknowledged the two principles underlying Canadian securities law relating to takeover defenses employed by a target board. The board's purpose in instituting

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[56] *See, e.g.*, OSA § 127(1) ("The Commission may make one or more of the following orders *if in its opinion it is in the public interest to make the order or orders* . . . .") (emphasis added).

[57] Ralph Shay, *Take-over Defences and Directors' Fiduciary Duties: Can National Policy 62-202 and the BCE Decision Live Side by Side?*, 2009–12 SECURITIES NEWSLETTER 1–2 (Dec. 2009); Telephone Interview with an Enquiries Officer, OSC (416-593-8314) (Mar. 2, 2011, 14:03).

[58] Interview with Enquiries Officer, *supra* note 47.

[59] *See* Kevin J. Thomson et al., *When "No" Means "Maybe"—the State of the "Just Say No" Defence in Canada*, THE 2011 LEXPERT/AMERICAN LAWYER GUIDE TO THE LEADING 500 LAWYERS IN CANADA A74 (2011), *available at* www.dwpv.com/images/Article_-_When_No_Means_Maybe.pdf.

[60] 15 O.S.C. Bull. at para. 10.

a SRP must be to "facilitat[e] an auction"; once the SRP has served this purpose, it is time for the SRP "to go" and for the target shareholders to decide.[61] The notion that a SRP should expire, and that it should be the securities commission that makes that determination, is the defining feature of the *Canadian Jorex* decision. This feature set the course for subsequent jurisprudence in Canada regarding takeover defenses in general and SRPs in particular.

The panel based its pro-shareholder paradigm on a conception of shareholders as sophisticated players in the capital markets. The panel explicitly voiced its confidence in shareholders' ability "to exercise one of the fundamental rights of share ownership—the ability to dispose of shares as one wishes."[62] The *Canadian Jorex* panel expressly rejected the proposal that the decision whether a hostile bid is acceptable should be left in the hands of the target board or its independent committee and their professional advisors:

> [W]e have every confidence that the shareholders of a target company will ultimately be quite able to decide for themselves, with the benefit of the advice they receive from the target board and others, including their own advisers, whether or not to dispose of their shares and, if so, at what price and on what terms. And to us the public interest lies in allowing them to do just that.[63]

Canada's securities commissions historically followed the OSC's *Canadian Jorex* paradigm with respect to NP 62-202. Commissions applied NP 62-202 consistently as against targets that instituted SRPs: "In the roughly 20 cases from 1991 to 2007, the only unpredictable aspect was the question of whether the pill would be cease traded immediately or a few weeks hence."[64] This consistency is based in an intent to apply a consistent interpretation of NP 62-202. Securities commissions have recognized that the law informs the behavior of market participants: "The rules of the game should be clear and consistently applied to encourage bidders to come forward."[65]

61 *Id*.
62 *Id.* at para. 15.
63 *Id.* at para. 16.
64 Shay, *supra* note 54, at 1.
65 Re Cara Operations Ltd., [2002] 25 O.S.C. Bull. 7997, para. 58 (Can.).

ii. *Royal Host* factors

Securities commissions have great flexibility and discretion in analyzing a board's conduct.[66] But a result of securities commissions' philosophy of consistency described above, case law interpreting NP 62-202 in the context of a review of a SRP converged on a number of factors that a commission considers in making its fact-specific determination.[67] These factors include, with regard to—

The company:

- The size and complexity of the target company; and
- Other defensive tactics, if any, implemented by the target company.

The SRP:

- When the SRP was adopted;
- Whether shareholder approval of the SRP was obtained; and
- Whether there is broad shareholder support for the continued operation of the SRP.

The bid:

- The length of time since the bid was announced and made;
- The nature of the bid, including whether it is coercive or unfair to the shareholders of the target company; and
- The likelihood that the bid will not be extended if the SRP is not terminated.

[66] *Cf.* Re Baffinland Iron Mines Corp., [2010] 33 O.S.C. Bull. 11385, para. 29 (Can.) ("Notwithstanding the principles referred to above, at the end of the day, there is no one test or consideration that constitutes the 'holy grail' when deciding whether a rights plan should remain in place or be cease traded.").

[67] Re Royal Host Real Estate Investment Trust, [1999] 22 O.S.C. Bull. 7819, para. 69 (Can.) (joint decision with ASC and BCSC).

The market:

- The steps taken by the target company to find an alternative bid or transaction that would be better for the shareholders;
- The number of potential, viable offerors; and
- The likelihood that, if given further time, the target company will be able to find a better bid or transaction.

The *Royal Host* factors also track the two principles underlying Canadian securities law relating to takeover defenses employed by a target board. A board likely will be subject to regulatory action where that board is well-protected by preclusive takeover defenses (particularly those that have not been approved by the target's shareholders) and yet has not attempted to leverage those defenses to initiate an auction or improve the original offer. In such circumstances, a securities commission will intervene on behalf of the target's shareholders, basing its intervention on NP 62-202.

Securities commissions have applied more stringent scrutiny to responsive defensive tactics.[68] Conduct that is subjected to this more stringent scrutiny includes so-called "tactical" SRPs (i.e., a SRP that is "adopted by a target board in the face of a bid, without shareholder approval").[69] Where a target board employs a tactical SRP in response to a bid, the board must demonstrate to the commission that the SRP was necessary "because of the coercive nature of the bid or some other very substantial unfairness or impropriety."[70] The commission then weighs the board's arguments in light of the other *Royal Host* factors and determines whether to cease-trade the rights issued pursuant to the SRP. In short, the commission expressly shifts the business judgment burden of proof from the shareholders to the board where the board uses a tactical SRP. By contrast, Canadian courts respect the board's business judgment even where the target is in play: the duties of the target board do not change.[71]

[68] *See, e.g.*, *Royal Host supra* note 68 (considering the date the SRP was adopted relative to the date of the bid).

[69] *Id*. at para. 54.

[70] *Id.* at para. 55 (quoting Re CW Shareholdings Inc. and WIC Western International Communications Ltd., [1998] 21 O.S.C. Bull. 2899, 2908 (Can.)).

[71] Pente Investment Management Ltd. v. Schneider Corp., [1998] 42 O.R.3d 177, para.

This more stringent scrutiny is grounded in the express language of NP 62-202.[72] Application of this policy has created explicit incentives for corporations to avoid "lame duck" defenses.[73] More specifically, it creates explicit incentives for a corporation to adopt a SRP and to have it approved by its shareholders—both well in advance of a bid. This "reward" for shareholder approval addresses an issue commonly encountered in the United States, whereby corporations embed takeover defenses in their charter that the shareholders did not contract for.[74] However, it also affords the board less leeway in responding to a given hostile bid.

iii. Target board's fiduciary duties

Given that securities commissions intervene in boards' decisions where they implicate most clearly their fiduciary duties, Canadian securities law effectively incorporates, and sometimes overlaps with, Canadian corporate law.[75] NP 62-202 and its associated case law purport to respect the target board's business judgment in a takeover situation—where appropriate. In NP 62-202, the CSA determined that it would have been "inappropriate to specify a code of conduct for directors of a target company" in addition to their duties of care and loyalty as required by corporate law.[76] However, NP 62-202 expressly identifies the "possibility that the interests of management of the target company

36 (Ont. Can.).

[72] Shay, *supra* note 54, at 2; *see* NP 62-202, § 1.1(4).

[73] *Cf.* Robert C. Clark and Leo Strine Jr., Harvard Law School, Lecture to Mergers, Acquisitions, and Splitups at Harvard Law School: Who Decides? Episode I (Sept. 28, 2010) (describing "lame duck" defenses as those defenses erected during or immediately preceding a hostile bid). The TSX has always required that any SRP adopted by a TSX-listed company be approved by the corporation's shareholders within six months of the SRP's adoption. *See also* Shay, *supra* note 43 at 2. However, as discussed above, satisfaction (or not) of this requirement usually has been only one of the many factors that a securities commission considers in assessing the validity of a SRP, tactical or not. And anyway most takeover battles are over well before the six-month deadline for TSX listing requirements.

[74] Interview with John C. Coates IV, Harvard Law School (Mar. 8, 2011). This situation can arise when the charter is amended unilaterally after a merger or in a reorganisation of the corporation, or when the corporation first goes public.

[75] Re Lions Gate Entertainment Corp., 2010 BCSECCOM 233, para. 33 (Can.) (citing to Re BCE Inc., [2008] 3 S.C.R. 560 (Can.) (asserting that a board has a fiduciary duty "to act in the best interests of the corporation").

[76] NP 62-202 § 1.1(3).

will differ from those of its shareholders."[77] This mistrust of management and the board is the foundational assumption that Canadian securities commissions rely on to inform and to justify their interventionist paradigm.

c. Current State of the Law Regarding SRPs: Aberrations and Turmoil

Recent SRP jurisprudence for the most part has followed and reaffirmed the interventionist paradigm established in *Canadian Jorex* and NP 62-202. In 2010, the BCSC and the OSC each cease-traded a SRP in two high-profile decisions—*Re Lions Gate Entertainment Corp.*[78] and *Re Baffinland Iron Mines Corp.*,[79] respectively. Both panels applied traditional Canadian principles regarding takeover defenses. Their decisions suggest that the core of those principles remains well-established among Canada's securities commissions. However, both panels expressly responded to prior case law that took a different approach to one particular issue in the law of takeover defenses: the ability of a target board to "just say no" in the face of a hostile bid and rely on a SRP to maintain the status quo. [80]

Commentators point out that inconsistencies and uncertainties continue to exist at the fringes of the law governing the use of a SRP in the hostile takeover context. Notwithstanding their agreement on core principles of securities law, the *Lions Gate* case and the *Baffinland* case are not entirely coterminous regarding the ability of a board to "just say no" in certain circumstances. Specifically, the effect of a shareholder vote on the legitimacy of a SRP where the board does not search for alternative transactions remains uncertain in Ontario.[81] And the prior case law that those cases addressed continues to represent an alternative, and some would say more enlightened,[82] take on the issue. That being

[77] *Id.* at § 1.1(1).

[78] 2010 BCSECCOM 233 (Can.).

[79] [2010] 33 O.S.C. Bull. 11385 (Can.).

[80] Re Neo Material Technologies, [2009] 32 O.S.C. Bull. 6941 (Can.) and Re Pulse Data Systems, [2007] 39 B.L.R. (4th) 138 (ASC Can.).

[81] *See, e.g.*, Julius Melnitzer, *Baffinland helps clear air on poison pills*, LAW TIMES, Dec. 20, 2010 (quoting Thomas Yeo, Torys LLP), http://www.lawtimesnews.com/201012208114/Headline-News/Baffinland-helps-clear-air-on-poison-pills.

[82] *Cf.* Kevin Marron, *"Poison pill" policies all over the map*, INVESTMENT EXECUTIVE, Dec. 06, 2010 (quoting Kevin Thomson, Davies Ward Phillips & Vineberg LLP), http://www.investmentexecutive.com/client/en/News/DetailNews.asp?id=56068&pg=1&Id

said, even this more enlightened view is insufficient: Canadian securities law takes for granted that securities commissions have the power to, and should, intervene directly in the affairs of the corporation in a takeover situation.

i. The BCSC decides *Lions Gate*, reiterates the auction principle

In *Lions Gate*, the BCSC held that individual shareholders must be given the opportunity to respond to a hostile bid directly by deciding whether to tender their shares.[83] The majority of the *Lions Gate* panel determined that shareholders cannot collectively tie their own hands by voting to approve an SRP where the board has not taken steps to seek any competitive bid or alternative transaction for the target's shareholders.[84] As a result of this holding, a board cannot use an SRP to maintain the status quo and continue to pursue its existing business plan after determining it to be in the best interests of the corporation, even where they submit that decision to shareholders for an informed uncoerced vote.

The majority's decision conceded that in general shareholder ratification of an SRP can be relevant under *Royal Host*.[85] Yet the panel asserted that such ratification is not determinative and is only relevant "in the context of what the SRPs were for"; i.e., allowing the board time and leverage to initiate an auction.[86] The panel held that evidence of shareholder ratification is only relevant where the target board will use the SRP to buy additional time to solicit a competing bid or other superior transaction.[87] Since the Lions Gate board had determined to take no steps to seek such an alternative bid or transaction,[88] the majority of the panel concluded that the issue of shareholder approval of the SRP had been rendered moot.[89] This holding thereby reaffirmed the basic tenet of Canadian securities law regarding the purpose of the SRP. The target board has an obligation eventually to relent in the face of a takeover bid, but also to maximize shareholder value by means of an

Section=27&IdPub=204.

83 *Lions Gate*, 2010 BCSECCOM at paras. 24, 29.

84 *Id*. at paras. 55–57.

85 *Id*. at para 53.

86 *Id*. at para. 56

87 *Id.* at paras. 53–58.

88 *Id.* at paras. 16, 48.

89 *Lions Gate*, 2010 BCSECCOM at para. 54.

auction.

ii. The OSC decides *Baffinland*, reiterates the shareholder choice principle

In *Baffinland*, the OSC reiterated the holding in *Canadian Jorex* and reaffirmed that case as good law in Ontario. In so doing, the *Baffinland* panel rendered the OSC's position on SRPs relatively clear: an SRP is contrary to shareholder interests unless it is tied to a "genuine attempt to obtain a better bid."[90] The OSC expressly invoked the *Canadian Jorex* case, stating that

> . . . it is generally time for a shareholder rights plan "to go" when the [SRP] has served its purpose by facilitating an auction, encouraging competing bids or otherwise maximizing shareholder value. A [SRP] will be cease traded where it is unlikely to achieve any further benefits for shareholders.[91]

The *Baffinland* panel then cited *Canadian Jorex* to express confidence in shareholders' ability to decide how to dispose of their shares.[92] The *Baffinland* panel thereby reaffirmed a conception of shareholders as sophisticated entities "capable of making the relevant choices" with regard to competing bids for their shares,[93] just as the *Canadian Jorex* panel had twenty years earlier.

d. Aberration in SRP Jurisprudence: 2007–10

The specific holdings in the *Baffinland* case and the *Lions Gate* case must be understood as a direct response to post-2007 developments in SRP jurisprudence. In 2007 and 2009, the ASC and the OSC each declined to cease-trade an SRP in two high-profile decisions—*Re Pulse Data Inc.*[94] and *Re Neo Material Technologies Inc.*,[95] respectively. Both panels appeared to take a nontraditional approach to the question of whether a board can "just say no" in certain circumstances. Both panels respected the decision of a board acting *with* the authority of its shareholders but *without* any intent to create an auction by soliciting competing bids.

90 Melnitzer, *supra* note 83.
91 33 O.S.C. Bull. at para. 26.
92 *Id.* at para. 27 (citing Canadian Jorex, para. 15).
93 *Id.* at paras. 54–55.
94 [2007] 39 B.L.R. (4th) 138 (ASC Can.).
95 [2009] 32 O.S.C. Bull. 6941 (Can.).

In *Pulse Data*, the ASC declined to cease-trade an SRP instituted as the only response to a hostile takeover bid. The panel identified the protection of the bona fide interests of the target shareholders as its primary consideration in evaluating the Pulse Data SRP.[96] The panel determined that the Pulse Data shareholders had approved the SRP shortly before the bid, with the benefit of "an extraordinary amount of information on which to evaluate the Rights Plan in the face of the [Seitel] offer."[97] Furthermore, the ASC expressed a reluctance to interfere with a decision reached by a board exercising its fiduciary duty to act in the best interest of shareholders.[98]

In *Neo*, the OSC declined to cease-trade a SRP on similar grounds based on similar facts. First, the panel determined that:

> . . . there is no evidence that the process undertaken by the Neo Board to evaluate and respond to the Pala Offer, including the decision to implement the Second [SRP], was not carried out in what the Neo Board determined to be the best interests of the corporation and of the Neo shareholders, as a whole . . . .[99]

Second, the panel referred to (*i*) the fact that an "overwhelming majority" of Neo's shareholders approved the SRP, and (*ii*) the fact that Neo's shareholders were adequately informed and free from coercion.[100]

Both panels therefore seemed to apply a different test from the traditional application of NP 62-202 and the *Royal Host* factors. In neither case did the target board take any steps to seek out alternative transactions. But in each case, the panel determined that the target shareholders' recent informed and overwhelming approval of the SRP constituted the shareholders' express rejection of the offer.[101] This reasoning exemplifies a conception of the board as protecting the shareholders from themselves, thereby counteracting the collective action problem that faces every widely-held corporation in a hostile bid situation.[102] Additionally, both panels based their decisions in part on the

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96 *Pulse Data*, 39 B.L.R. at para 93.

97 *Id.* at para. 101.

98 *Id*. at para. 101(e).

99 32 O.S.C. Bull. at para. 18(b).

100 *Id.* at para. 18(c)–(e).

101 Allan Coleman and Cameron A. MacDonald, *The Path Forward: Poison Pills in Canada After Pulse Data, Neo, and Lions Gate*, OSLER HOSKIN & HARCOURT LLP – E-REVIEWS: CORPORATE REVIEW (Sept. 2010), *available at* http://www.osler.com/newsresources/Details.aspx?id=2822&col=.

102 *See* Robert C. Clark and Leo Strine Jr., *supra* note 74.

boards' exercise of their fiduciary duties under corporate law. The panels referred to the adequate process followed by the board and the efforts to ensure both board and shareholders were adequately informed. In particular, the *Neo* panel specifically referred to the SCC's recent formulation of the business judgment rule:[103] under the *BCE* case, the board's fiduciary duties in the face of a hostile bid are not limited solely to maximizing short-term profit or share value, and instead can be exercised for the broader purpose of protecting the long-term interests of shareholders.[104] The two panels thereby broke with conventional securities law doctrine, but acted in harmony with Canadian corporate common law.

e. Summation of Recent Jurisprudence: 2007–10

Commentators generally regard these recent decisions as addressing the availability of the Nancy Reagan defense to the boards of Canadian companies—i.e., whether a target board may "just say no" in the face of a hostile bid and rely on an SRP to maintain the status quo. Historically, boards have not been permitted to do so notwithstanding an informed determination that maintaining the status quo would be in the best interest of the corporation. The BCSC maintained that position even in the face of a shareholder vote ratifying that informed determination.[105] However, the OSC did not expressly state a position regarding the effect of a shareholder vote on a SRP where the board admitted it was not searching for alternatives.[106] There is some question whether *Neo* remains good law on that issue in Ontario. There is no question that *Pulse Data* remains good law in Alberta.

Where "the success or failure of a hostile takeover bid may well depend largely on the province in which the head office of the target company is located,"[107] a particular securities commission's silence on a particular salient aspect of SRP jurisprudence can cause unnecessary confusion among companies and their boards and investors. Such a "dichotomy in the regulatory system in Canada with regard to the

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103 *Neo*, 32 O.S.C. Bull. at para. 107.

104 *BCE*, 3 S.C.R. at para. 38.

105 *Lions Gate*, 2010 BCSECCOM at para 55

106 Melnitzer, *supra* note 83.

107 Kevin Marron, *"Poison pill" policies all over the map*, INVESTMENT EXECUTIVE, Dec. 6, 2010 (quoting Kevin Thomson, Davies Ward Phillips & Vineberg LLP), http://www.investmentexecutive.com/client/en/News/DetailNews.asp?id=56068&pg=1&IdSection=27&IdPub=204.

regulation of hostile change-of-control transactions" undermines investor confidence and inhibits the efficient functioning of Canada's capital markets.[108]

These interventionist approaches to a board's exercise of its fiduciary duties raise concerns about the way boards are regulated in the context of a takeover bid under current Canadian securities law. But even allowing shareholders to ratify the board's decision in a shareholder vote (as was the case in *Neo* and *Pulse Data*) is not an adequately hands-off approach. Commissions should allow boards the discretion to act in what they determine to be the best interest of the corporation. They should recognize that boards are constrained by their fiduciary duties and by free exercise of the shareholder franchise.

f. Potential Conflict Between Provincial Securities Law and Corporate Law Principles of Fiduciary Duty

Securities commission decisions before the *Neo* case have raised the tension that exists in Canada between securities law and corporate law. For example, in *Re Tarxien Corp.*, the OSC cease-traded an SRP even though the panel found no evidence that the defendant board had acted other than in what the directors believed to be the shareholders' best interests.[109] The panel determined that "whether the Directors of Tarxien had exercised their fiduciary duties in setting up the [SRP]" was not a "relevant [consideration] for the decision [that they] had to make."[110] This holding explicitly acknowledges that a different set of imperatives drives securities commissions, which necessarily influences boards.

However, from the perspective of a board of directors, the SCC's determination of the board's fiduciary duty is a highly relevant consideration for the decisions that they have to make. The Court's determination in the *BCE* case directly impacts the fiduciary duty calculus in the context of takeover defense strategies. In the *BCE* case, the Court held that:

> [t]he fiduciary duty of the directors to the corporation is a broad, contextual concept. It is not confined to short-term profit or share value. Where the corporation is an ongoing concern, it looks to the long-term interests of the corporation. The content of this duty varies

108 *Id.*
109 Re Tarxien Corp., [1996] 19 O.S.C. Bull. 6913, para. 25 (Can.).
110 *Id.*

> with the situation at hand. At a minimum, it requires the directors to ensure that the corporation meets its statutory obligations. But, depending on the context, there may also be other requirements. In any event, the fiduciary duty owed by directors is mandatory; directors must look to what is in the best interests of the corporation.[111]

This passage captures the tension between the board's duty to the corporation and the securities commission's public interest in shareholder well-being. Securities commissions, interpreting NP 62-202, focus exclusively on shareholder interests in the short term. On the other hand, the board must consider the long-term interest of the corporation as a whole, and is not subject to the same shareholder-primacy *Revlon* duties as in the United States.[112] "There is no principle [in Canadian corporate law] that one set of interests—for example the interests of shareholders—should prevail over another set of interests."[113] In fact, this conception of the board's fiduciary duties "could be seen to *obligate* a board of directors to embark on a course of action that is inconsistent with NP 62-202"[114] and its inherent skepticism toward a board's business judgment in a takeover context—which skepticism is contrary to Canadian corporate common law.

Securities commissions have taken this skeptical stance to heart. For example, in *Re Consolidated Properties Ltd.*, the OSC stated that:

> [i]f there appears to be a real and substantial possibility that, given a reasonable period of further time, the board of the target corporation can increase shareholder choice and maximize shareholder value, then, absent some other compelling reason requiring the termination of the [SRP] in the interests of shareholders, it seems to us that the Commission should allow the [SRP] to function for such further period, so as to allow management and the board to continue to fulfil their fiduciary duties.[115]

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[111] *BCE*, 3 S.C.R. at para. 38.

[112] *Id.* at para. 87 ("the *Revlon* line of cases has not displaced the fundamental rule that the duty of directors cannot be confined to particular priority rules, but is rather a function of business judgment of what is in the best interest of the corporation, in the particular situation it faces.").

[113] *Id.* at para. 84.

[114] Shay, *supra* note 58, at 3. (emphasis added).

[115] [2000] 23 O.S.C. Bull. 7981, para. 35 (Can.) (citing Re MDC Corp. and Regal Greetings and Gifts Inc., [1994] 17 O.S.C. Bull. 4971, 4979 (Can.)).

The *Consolidated Properties* panel thereby acknowledged the role that corporate law fiduciary duties play in guiding the target board's decision-making regarding a SRP or other takeover defenses. But the panel—acting with reference to NP 62-202—expressly substituted its own judgment for that of the board's regarding the likelihood that the board "can increase shareholder choice and maximize shareholder value."[116] Similarly, the panel reserved to itself the determination of what would constitute a "reasonable period of further time" and what would constitute a "compelling reason requiring the termination of the [SRP]."[117]

In overseeing the board's fulfillment of their fiduciary duties, the panel made its own independent assessment of the circumstances of the takeover contest and applied its own judgment to those circumstances. This tradition of exercising independent assessment and judgment was established in the *Canadian Jorex* case.[118] It is central to the regulatory function that Canadian securities commissions serve in constraining target board action in the face of a hostile takeover bid. Such a tradition underlying a system of securities regulation betrays (*i*) an intense mistrust of the target board's willingness to fulfill its fiduciary duties in a takeover situation and (*ii*) a lack of faith in the statutory regime that Canada's legislatures have created to protect the shareholder franchise. Instead, this tradition represents a reliance on active regulatory bodies to make the necessary determinations and oversee, on behalf of the corporation's shareholders, the board's actions on behalf of those shareholders. However, that well-established tradition of independent judgment runs contrary to a fundamental principle in both Canadian and American corporate law: that directors and shareholders should decide, not courts nor regulators.

The tension between court and securities commission played out in *Neo* and subsequent case law. Based on that case law, Canada's securities commissions seem to have settled on a position that undermines the Supreme Court's conception of fiduciary duty in situations where the exercise of those duties is most context-specific and where the tension between short-term and long-term value is cast in starkest relief.

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116 *Id*

117 *Id*.

118 *See* text accompanying notes 61–66.

Canada's securities commissions might have let directors make those important determinations according to fiduciary duties that are determined and enforced by courts and prosecuted by shareholders. Instead, commissions insert themselves into the mix and impose their own conception of what the best outcome might be in a hostile bid situation. Commissions act based on their opinion of the outcome that they believe to be in the "public interest" despite having no robust incentives to determine definitively what that public interest is in any given situation. As a result, they end up imposing a tight and largely inflexible[119] timeline in which a besieged board is expected to defend its shareholders from the siren song of a bid premium—and its promise of immediate gratification for shareholders, many of whom are operating on such thin margins that locking in any gain is a victory—with words alone.

III. ANALYSIS AND PROPOSAL

1. Introduction

a. Canada, the United States, and the *Interco* case

Despite better protection of the shareholder franchise, Canada is more restrictive of boards' use of takeover defenses. Canada's system is essentially identical to the approach to takeover defenses outlined in *City Capital Assocs. Ltd. P'ship v. Interco Inc.*[120] In *Interco*, Chancellor Allen held that a board's good faith determination that an offer was inadequate could justify leaving a takeover defense such as an SRP in place for some "period" of time while the board worked to protect shareholder interests.[121] Chancellor Allen's model provided that a board could protect shareholder interests by negotiating with the bidder, seeking out an alternative transaction, or presenting an alternative of its own to the shareholders.[122] But "[o]nce that period has closed . . . and [the board] has taken such time as it required in good faith to arrange an alternative value-maximizing transaction, then, in most instances, the legitimate role of the [SRP] in the context of a non-coercive offer will

[119] Thomson et al., *supra* note 49 ("Generally, the commissions will cease trade the pill somewhere in the range of 45 to 70 days after the start of the unsolicited bid.").

[120] 551 A.2d 787 (Del. Ch. 1988).

[121] *Id.* at 798

[122] *Id.*

have been fully satisfied."[123] The Delaware Supreme Court gave that case severely negative treatment in *Paramount Communications Inc. v. Time Inc.*[124] As a result, subsequent American jurisprudence took a different path from the one outlined in the *Interco* case.[125] Yet it is the *Interco* paradigm that underlies the *Canadian Jorex* approach to takeover defenses.

Justice Jacobs of the Delaware Supreme Court might consider Canada's *Interco*-like approach to be more enlightened and forward-looking than the United States' "paternalistic model" of shareholder protection in light of the increasing sophistication of shareholders that he sees in modern capital markets.[126] Justice Jacobs's observations apply equally, if not more, in Canada. In Canada, an even more significant percentage of shareholders in corporations across the capital markets are, or are represented by, sophisticated institutional shareholders.[127] But though shareholders in both countries have "[come] to be viewed as highly sophisticated investors with no need of protection by boards, and only to a limited extent by courts,"[128] Delaware law has retained the concept of substantive coercion and its attendant permission of board discretion in the face of takeover bids. Since the *Time* case Delaware courts have not independently determined whether an SRP has expired and therefore should be struck down. As recently confirmed in the *Airgas* case[129] (foreshadowed by, inter alia, the Delaware District Court's opinion in *Moore Corp. v. Wallace Computer Servs. Inc.*[130]), the board of directors of a target corporation is entitled to use an SRP for as long a period of time as the board deems warranted. This stance generally persists notwithstanding Delaware decisions such as the

123 *Id.*

124 571 A.2d 1140, 1152–53 (Del. 1990) (though never expressly overruled it as the *Interco* case did not come before that court).

125 *See, e.g.*, Air Prods. & Chems. Inc. v. Airgas Inc., 16 A.3d 48 (Del. Ch. 2011).

126 Jack B. Jacobs, *Paradigm Shifts in American Corporate Governance Law: A Quarter Century of Experience*, 15 CORP. GOVERNANCE ADVISOR 1, 2 (Sept./Oct. 2007).

127 *See* Hansell, et al., The Quality of the Shareholder Vote in Canada 6, Note 3 (Davies Ward Phillips & Vineberg LLP, Discussion Paper) (Oct. 22, 2010), http://www.dwpv.com/Sites/shareholdervoting/media/The-Quality-of-the-Shareholder-Vote-in-Canad.pdf ("According to Bloomberg, as of August 2010, the average holding by institutional investors in S&P/TSX 60 Index companies is 56.79%.").

128 Jacobs, *supra* note 128, at 3.

129 *Airgas*, 16 A.3d at 48.

130 907 F. Supp. 1545 (D. Del. 1995).

Chesapeake case and the *Topps* case,[131] and notwithstanding Chancellor Chandler's own apparent ambivalence about the wisdom of the doctrine.

Instead, as Justice Jacobs writes, the American corporate law system "relies heavily upon shareholder voting as the basis to legitimize corporate action" by directors who decide "how to deploy billions of dollars of assets that the directors do not own."[132] In the United States, the board is limited primarily by the constraints imposed by the shareholder franchise, which reinforces the U.S.'s "representative democracy" model of corporate governance. This powerful motif has run through Delaware case law since the *Blasius* case—even though Delaware's protections of the shareholder franchise are less robust than those in Canada. Specifically, Delaware General Corporation Law § 141(d) permits classified boards of directors.[133] Further,Delaware case law has permitted implicit assaults on the shareholder franchise, notwithstanding the equitable imperatives of the *Blasius* case.[134]

b. Canada and the Shareholder Franchise; Proposal

These techniques, permitted and even common in the U.S.,[135] are

[131] Jacobs, *supra* note 128, at 3 (citing Chesapeake Corp. v. Shore, 771 A.2d 293 (Del. Ch. 2000) (holding that if shareholders are smart enough to decide whether to invest in a particular company without board intervention, then they should be regarded as intelligent enough to decide whether to exit that investment), and In re The Topps Co. Shareholder Litig., 924 A.2d 951 (Del. Ch. 2007) (ordering target company to amend its proxy statement to include material facts that would enable the target shareholders to choose between the two competing offers on an informed basis, on the basis that the target's highly sophisticated shareholders could decide for themselves whether or not to tender (and into which offer to tender) so long as they had adequate information).

[132] *Id.* at 4 (citing Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988), and stating parenthetically that "[t]he shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests.").

[133] DEL. CODE ANN. tit. 8, § 141(d) (2011).

[134] *See, e.g.*, Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1388–89 (Del. 1995). In *Unitrin*, the court allowed the Unitrin board to put in a SRP then to "thin the herd" by repurchasing (likely) antagonistic votes, thereby tilting the playing field steeply in their favor. Robert C. Clark and Leo Strine Jr., Harvard Law School, Lecture to Mergers, Acquisitions, and Splitups at Harvard Law School: The Death of "Enhanced" Scrutiny (Oct. 19, 2010).

[135] Robert C. Clark and Leo Strine Jr., Harvard Law School, Lecture to Mergers, Acquisitions, and Splitups at Harvard Law School: The Death of "Enhanced" Scrutiny (Oct. 19, 2010); Mark Gordon, Wachtell Lipton Rosen & Katz LLP, Lecture to the Mergers & Acquisitions Workshop at Harvard Law School: Course Overview – Seeing the Forest (Jan. 3, 2011).

for the most part unavailable to Canadian boards. Canadian courts scrutinize discriminatory repurchases in the context of a hostile takeover bid and generally will prevent directors from manipulating the shareholder franchise by such means.[136] As discussed below, shareholders of Canadian corporations are entitled to call (or "requisition") a special meeting at any time and may remove any director by ordinary resolution at that meeting. These are strong safeguards of the shareholder franchise. Canada should recognize that those safeguards are sufficient, should adopt a more permissive stance toward regulation of takeover defense, and should trust shareholders to decide for themselves whether the directors are acting in their interests and in the interests of the corporation.

Acting on this proposal requires a number of changes, which at least requires rethinking NP 62-202 and the role of the CSA in developing national securities law. But, overall, so fundamentally changing the way securities law operates in Canada likely requires a national securities regulator. Enacting the legislation to create a national securities regulator would provide the opportunity to revise and limit the public interest jurisdiction that provincial securities commissions currently use to intervene in hostile takeover situations. The statutory authority that the commissions have under provincial securities law is too broad and too ill-defined. Moreover, this broad jurisdiction has permitted the commissions to develop a body of case law that effectively contradicts the law of the land as handed down by the Supreme Court of Canada. Canada's Parliament should resolve this conflict in the regulation of Canada's corporations. Parliament should limit the commissions' ability to continue undermining corporate law fiduciary duties. Parliament should trust the statutory regime that it and the provincial legislatures have developed to protect shareholder franchise.

This argument to depend on shareholder franchise is particularly persuasive in a capital market such as Canada's where institutional

[136] *See, e.g.*, 347883 Alberta Ltd. v. Producers Pipelines, Inc., [1991] 80 D.L.R. (4th) 359 (Can. Sask. Ct. App.) (holding that board could not offer a discriminatory share repurchase program to dilute plaintiff–shareholder). *But see* 360713779 Icahn Partners LP v. Lions Gate Entm't Corp., [2010] B.C.S.C. 1547, 75 B.L.R. (4th) 212, paras. 178–86 (Can.) (permitting the board to convert debt to equity in advance of a proxy battle where the CEO knew that the former debtholder would support the board rather than the bidder, based on ulterior motives of the plaintiff–shareholder and in light of benefits of the deleveraging to the corporation).

shareholders predominate. Institutional investors own on average over half of the shares of every company on the S&P/TSX 60 Index.[137] These market conditions reduce the voter apathy collective-action problem with regard to exercise of the shareholder franchise that might prevail in a more dispersed capital market. These institutional investors are professional shareholders: it's their job to monitor directors. Relying on the shareholder base and its franchise to discipline directors therefore becomes a viable option.

Relying on the shareholder franchise also addresses the problems associated with a high level of institutional shareholder ownership. Institutional investors are influenced by short-term imperatives.[138] Merger arbitrage is a serious issue, as bids (or tender offers) present opportunities for opportunistic share purchases and sales. Chancellor Chandler recognized this issue in the *Airgas* case. In *Airgas*, the Chancellor held that a board could maintain an SRP in the face of a hostile bid based on a substantive coercion rationale in large part because of the threat of arbitrageurs: "The threat of 'arbs' is a new facet of substantive coercion, different from the substantive coercion claim recognized in *Paramount*."[139] The Chancellor found "sufficient evidence that a majority of stockholders might be willing to tender their shares regardless of whether the price is adequate or not", because "a large number—if not all—of the arbitrageurs who bought into Airgas's stock at prices significantly below the $70 offer price would be happy to tender their shares at that price regardless of the potential long-term value of the company."[140]

Canada's "forced sale-by-auction" model enables such short-term thinking by shareholders to prevail—and even encourages it. Shareholders can do what they like with their own property. They are entitled to sell their shares to a willing buyer on the open market. However, a takeover bid is not about individual shareholders selling their individual property. It is about selling control of a corporation. Shareholders have no right to a control premium under *either* Canadian law *or* American law. But boards do have a right to manage the

[137] Hansell, et al., *supra* note 129, at 6.

[138] Leo E. Strine Jr., *One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?*, 66 BUS. LAW. 1, 10 (Nov. 2010) ("For a variety of reasons, these institutional investors often have a myopic concern for short-term performance.").

[139] *Airgas*, 16 A.3d at 108.

[140] *Id.* at 111.

corporation and craft its business strategy. Selling a corporation is a business strategy decision related to the management of the corporation. Accordingly, that decision should be left to the board.

Channeling the decision-making by Canadian shareholders into the proxy vote would avoid a heat-of-the-moment snap decision whether to tender to a bid and would prevent opportunistic cost-conscious bottom-line oriented shareholders from derailing the corporation's long-term business strategy for the promise of a couple of bucks. It would allow for a more rational business planning–oriented decision by shareholders as well as by the board.

2. Operation of Canada's Proxy Vote Safety Valve.

a. Shareholder Meetings

i. The good

The classified board is effectively impossible in Canada. Formally, a corporation may create a classified board in its charter, but shareholders of a Canadian corporation may remove a director by ordinary resolution (i.e., by a simple majority[141]) *either* at the corporation's annual general meeting *or* at a special meeting requisitioned for that purpose (by the holders of at least five percent of the corporation's issued voting shares). Moreover, a corporation's articles may not provide that the number of shareholder votes required to remove a director be greater than a simple majority.[142] The shareholders then can choose to fill the vacancy created by removing a director at the same meeting.[143] A court will not interfere with a properly-called shareholder meeting merely because the purpose of that meeting is to remove directors and elect a new board.[144]

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[141] Business Corporations Act (Ontario), R.S.O., ch. B 16 (1990) ("OBCA"), §§ 5(5), 122(1) (Can.) (subject to the qualification that "a director may not be removed from office if the votes cast against the director's removal would be sufficient to elect him or her and such votes could be voted cumulatively at an election at which the same total number of votes were cast and the number of directors required by the articles were then being elected," § 120(f)); Canada Business Corporations Act, R.S.C., ch. C 44 (1985)("CBCA"), § 6(4) (Can.).

[142] Fox v. Castello Casino Corp., [2000] 8 B.L.R. (3d) 68 (Ont. Sup. Ct.).

[143] CBCA § 109(1); OBCA § 122(1); *see* Bill Gula & Richard Fridman, *Unsolicited Takeover Bids: Defensive Strategies*, Guide to the Leading 500 Lawyers in Canada, Jan. 2, 2006, http://www.dwpv.com/en/17623_17198.aspx.

[144] *Fox v. Castello Casino Corp.*, 8 B.L.R. at 68. However, where that is the purpose of

The board must call a meeting within twenty-one days of receiving notice from the requisitioning shareholder. The board then must send the notice as specified in the corporation's bylaws; though the OBCA limits the permissible advance-notice range for public companies to between twenty-one and fifty days before the actual meeting.[145] If the board fails to call the requisitioned meeting, then the requisitioning shareholder may do so.[146] Shareholders are entitled to claim reimbursement from the corporation "for the expenses reasonably incurred by them in requisitioning, calling and holding the meeting"—which expenses include the cost of publishing notice to all shareholders.[147]

Together these statutory protections enshrine the shareholders' right to determine who represents them on the corporation's board. Relative to shareholders in American corporations, shareholders in Canadian corporations are well-positioned to discipline their agents, the directors. Directors effectively are constantly up for election. Canadian regulators and legislators should respect and reinforce this model of corporate accountability and control rather than create a regulatory environment where corporations are constantly in play. The solution is to allow directors to make decisions regarding the corporation's business strategy while ensuring that shareholders have these necessary mechanisms to discipline their agents.

ii. The bad

Notwithstanding the statutory protection that Canadian shareholders enjoy in disciplining directors, the field is not entirely tilted in the shareholder's favor. For example, shareholders typically cannot raise a motion to remove a director from office directly from the floor during a shareholder meeting.[148] Accordingly, removal of a director typically is accomplished by shareholder proposal and so potentially is

the meeting, the meeting notice must state that an election is to be held upon successful removal of the challenged director.

[145] OBCA § 96(1); *cf.* CBCA § 135(1), Reg. 44 (setting sixty days as the maximum of the range). Under both statutes, for private companies the minimum is ten days.

[146] OBCA § 105(4); CBCA § 143(4).

[147] OBCA § 105(6); CBCA § 43(6).

[148] M. KAYE KERR & HUBERT W. KING, PROCEDURES FOR MEETINGS AND ORGANIZATIONS 185 (Carswell Legal Publications, 1984). If specific notice for the item is required, the motion may not be raised directly from the floor during the meeting.

subject to several procedural hurdles.[149]

In order to submit a proposal (to remove a director or otherwise), the shareholder must satisfy certain requirements. The investor must *either*:

- Own not less than five percent of the corporation's issued voting shares;
- Have registered those shares (or else forego the right to submit a proposal requisitioning a special meeting at all); *and*
- "[H]ave held an interest in at least [one per cent] of the corporation's shares with a market value of at least $2,000.00 for at least six months prior to the day before the shareholder submits its proposal";

Or:

- "[H]ave the support of other investors who meet those requirements in the aggregate."[150]

And "[i]f the person who submits the proposal fails to continue to satisfy [these] criteria up to and including the date of the meeting, then for a period of two years after the date of that meeting, any proposal made by that person will not be included in any management [information] circular [i.e., in management's proxy materials]."[151]

An eligible shareholder submitting a proposal to remove a director of a public company must provide valid notice of the special meeting to each (voting) shareholder. The proposing shareholder must send the notice as specified in the corporation's bylaws, though the OBCA limits the permissible advance-notice range to between twenty-one and fifty days before the actual meeting.[152]

The notice must include the text of any special resolution. It also must include a statement describing any special business to be

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[149] Hansell, et al., *supra* note 129. ("[A] matter that is put on the agenda of a meeting of shareholders at the initiative of one or more shareholders, rather than the initiative of management.") (referring to the CBCA and the OBCA).

[150] *Id.* at 45–46 (quoting, at note 104, Canada Business Corporations Regulations, 2001, S.O.R./2001-512, § 46 (Can.)).

[151] *Id.* at 45.

[152] OBCA § 96(1); *cf.* CBCA § 135(1), Reg. 44 (setting sixty days as the maximum of the range). Under both statutes, for private companies the minimum is ten days.

transacted at the meeting "in sufficient detail to permit [a] shareholder to form a reasoned judgement" on the matter at issue.[153] However, any shareholder proposal and statement relating to special business together cannot exceed 500 words.[154] Even if shareholders manage to get on the meeting agenda, "currently many shareholders are rushed through their presentation, often being timed with a large clock."[155] On the other hand, a director who is the subject of a proposal to be removed has a right to attend the meeting and be heard,[156] including via written statement that is read by the meeting's chairman.[157]

Moreover, the corporation is not required to circulate a shareholder proposal or any statement made in connection with a proposal where:

- The proposal is not submitted to the corporation at least sixty days before the anniversary date of the last annual meeting (if the matter is proposed to be raised at an annual meeting), or at least sixty days before a meeting other than the annual meeting (if the matter is proposed to be raised at a meeting other than the annual meeting);
- It clearly appears that the primary purpose of the proposal is to enforce a personal claim or redress a personal grievance against the corporation or any of its directors, officers or security-holders;
- It clearly appears that the proposal does not relate in any significant way to the business or affairs of the corporation;
- Not more than two years before the receipt of the proposal, a person failed to present, in person or by proxy, at a meeting of shareholders, a proposal that, at the person's request, had been included in a management information circular relating to the meeting; *or*
- Substantially the same proposal was submitted to

153 OBCA § 96(6)(b).

154 O. Reg. 59/07 (Can.), R.R.O. 1990, Reg. 62, para. 23.4 ("For the purposes of subsection 99(3.1) of the Act, the proposal referred to in subsection 99(2) of the Act and the statement referred to in subsection 99(3) of the Act shall together not exceed 500 words.").

155 HON. MICHAEL D. CHONG, M.P., STATUTORY REVIEW OF THE CANADA BUSINESS CORPORATIONS ACT: REPORT OF THE STANDING COMMITTEE ON INDUSTRY, SCIENCE AND TECHNOLOGY 12 (June 2010) (citing testimony of Laura O'Neill, SHARE, to the Standing House of Commons Committee on Industry, Science and Technology, Meeting No. 43 (Nov. 16, 2009, 16:00)), *available at* http://publications.gc.ca.

156 OBCA § 123(1); CBCA § 110(1).

157 OBCA § 123(2); CBCA § 110(1).

> shareholders in a management information circular or dissident's information circular relating to a meeting of shareholders held within two years preceding the receipt of the shareholder's request and the proposal was defeated.[158]

The process of shareholder proposal submission can be litigated in two ways related to these grounds. The corporation may apply affirmatively to a court to restrain circulation of a shareholder proposal with its management information circular.[159] Alternatively, the corporation may just refuse to circulate the proposal and prompt the shareholder to apply to a court to order that management include the proposal, typically requiring that the shareholder attempt to delay the meeting at which the proposal would be voted on.[160] These potential responses by the corporation to a shareholder proposal to remove a director potentially increase the cost and delay associated with a shareholder meeting. The cost and delay limit the protection that Canada's statutory regime affords to shareholders.

However, these restrictions on shareholder ability to initiate a proxy battle to challenge a particular director or the entire board are not unreasonable. Canada's statutory regime protects the exercise of the shareholder franchise, but also provides procedural checks that strive to protect the board from frivolous or malicious shareholder conduct.

iii.The ugly

For shareholder voting to be an effective tool in constraining and disciplining directors, the mechanisms by which votes are cast and counted need to be robust and reliable. However, the current state of the proxy voting system limits the effectiveness of the shareholder franchise in determining the will of a corporation's shareholders. Improving the integrity of the system in practice would allow Canada to rely with more confidence on its admirable statutory protection of the shareholder franchise.

The proxy voting system has several issues.[161] First, the system is complicated and opaque. Many parties (often acting through third party representatives) interact and communicate with one another by means

158 OBCA § 99(5).
159 OBCA § 99(9); CBCA § 137(9).
160 OBCA § 99(8); CBCA § 137(8) (reen. 2001, § 59(4)).
161 The following paragraph is based on Hansell, et al., *supra* note 129, at ii–iii.

susceptible to administrative and technological error. This error is difficult to identify and correct because of the multiple parties involved and the lack of an established system of interaction. Second, there is one proxy agent for almost all intermediaries in Canada. This proxy agent's conduct and compliance with what regulation exists currently are not regulated. Third, votes may be cast by persons who have no economic interest in the issuer. This separation of voting interest and economic interest means that voting is susceptible to strategic manipulation on behalf of interests other than the long-term success of the corporation. Fourth, how the votes are tabulated and proxies are cast is completely unregulated. Moreover, securities regulators do not monitor compliance with those aspects of the system that they do regulate.

However, practitioners have begun a dialogue proposing solutions to the problems with the proxy voting system. This dialogue has brought public attention to these issues.[162] The dialogue and attention is encouraging, suggesting that there is appetite for change in Canada's legal and business communities.

Another hurdle is the use of director slates in board elections. Approximately twenty-five percent of Canada's largest public corporations currently use slate voting for directors.[163] This means that it is difficult for shareholders to target their dissatisfaction against particular directors. However, there is a bright light on the horizon. Traditionally proxy contests have been rare in Canada; takeover bids have been "the principal method by which an acquiror will seek to acquire control of a target company on a non-negotiated basis" because of their high likelihood of success under the Canadian system.[164] But more recently shareholders have been starting to use their votes to express dissatisfaction with particular directors, especially as

[162] *See, e.g.*, Drew Hasselback, *Quality of the Shareholder Vote*, NATIONAL POST, Feb. 16, 2011, *available at* http://business.financialpost.com/2011/02/16/quality-of-the-shareholder-vote/#more-27989 (discussing Hansell, *The Quality of the Shareholder Vote in Canada*).

[163] HON. MICHAEL D. CHONG, M.P., STATUTORY REVIEW OF THE CANADA BUSINESS CORPORATIONS ACT: REPORT OF THE STANDING COMMITTEE ON INDUSTRY, SCIENCE AND TECHNOLOGY 12, (June 2010) (citing Testimony of Judy Cotte, CCGG, to the Standing House of Commons Committee on Industry, Science and Technology, Meeting No. 43 (Nov. 16, 2009, 15.55 PM)).

[164] WILLIAM J. BRAITHWAITE AND JOHN J. CIARDULLO, STIKEMAN ELLIOTT LLP, M&A IN CANADA 3, (May 2004), www.stikeman.com/newslett/IFLRMA04.pdf; *see also* Marvin Yontef and Simon Romano, *Canada*, § 3.3, *in* ICLG TO: MERGERS & ACQUISITIONS 2008, *available at* www.iclg.co.uk.

shareholders respond to a flagging economy with increased levels of activism.[165]

As a result there has been "an increase in the number of proxy battles for control of boards of directors."[166] Majority voting has facilitated these trends as that system becomes more common among Canadian corporations. Specifically,

> [i]n 2010, of the 142 issuers who reported their voting results for director elections, the average percentage of votes withheld was 8.9 percent of votes cast. Fifteen issuers had at least one director that received 20 percent or more votes withheld with respect to his or her nomination. Seven issuers had at least one director that received 25 percent or more votes withheld with respect to his or her nomination.[167]

Given the limited ability of a Canadian corporation to build structural defensive measures directly into its charter or bylaws,[168] this uptick in proxy battle activity represents a potentially positive trend in exercise of the shareholder franchise that regulators and legislators should respond to.[169]

b. Written Consent

Shareholders have an option other than taking action at a meeting. Shareholders also may act by unanimous written consent through "a resolution in writing signed by all the shareholders [or their attorney authorized in writing] entitled to vote on that resolution at a meeting of shareholders." This type of resolution "is as valid as if it had been passed at a meeting of the shareholders" and satisfies all requirements of the Act relating to that meeting of shareholders. The only relevant exception to this written consent option is where a director being removed decides to submit a written statement in his defense, as

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165 Telephone Interview with Sean Farrell, McMillan LLP (Apr. 19, 2011).

166 Sean Farrell & Robert McDermott, *Canada*, *in* MERGERS AND ACQUISITIONS IN 61 JURISDICTIONS WORLDWIDE: 2010 55 (Casey Cogut ed.) (Law Business Research Ltd., 2010) (1998), *available at* http://www.gettingthedealthrough.com/books/21/mergers-acquisitions/.

167 Hansell, et al., *supra* note 129, at 12–13.

168 *See* TORYS LLP, TAKEOVER BIDS IN CANADA AND TENDER OFFERS IN THE UNITED STATES: A GUIDE FOR ACQUIRORS AND TARGETS 30–31 (2009), http://www.torys.com/Publications/Documents/Publication%20PDFs/Takeover_Bids_Guide_2009.pdf (enumerating defensive measures common in the U.S. and contrasting Canada).

169 *Cf.* Thomson et al., *supra* note 60, at A74. (contrasting Canada's liberal director removal process with proxy battles in the U.S., which "can be a time consuming proposition that can last well over a year").

provided by subsection 123(2) of the OBCA.[170]

3. A Selection of Alternative Proposals

a. "Time-test" proposal

One alternative proposal to change the current state of Canadian takeover defense regulation is to extend the amount of time during which boards are permitted to keep an SRP in place.[171] Its proponent argues that more time would "enable[ ] management to formulate a superior strategic alternative" rather than "being forced to relinquish control due to external circumstances."[172]

However, such a proposal assumes that there are circumstances where a transaction is not in the best interests of the corporation but shareholders nevertheless would tender to a hostile bid. Furthermore, perpetuating the time-test approach to takeover defense regulation cannot help but impose yet another arbitrary limit on the amount of time where that period of time is decided by a regulator and not by the board or by shareholders. A regulation-based "solution" raises the related questions of "who knows best?" and "who decides?" The time-test proposal answers these questions by vesting power in regulators. But it is the board and the shareholders that we actually should allow to make major transformational decisions with regard to the fate of the corporation.

Moreover, such a proposal does not adequately countenance the relative ease with which directors can be removed from Canadian boards. Boards need the added protection of the SRP to balance against that constant threat of impeachment that they face, directors still can be sued for breach of fiduciary duty or for interfering with exercise of the shareholder franchise. The U.S. historically has relied more heavily on these tools notwithstanding their less robust character there.[173] Canada should capitalize on its advantages in protection of the shareholder franchise.

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170 OBCA § 123(1)-(2).

171 *See, e.g.*, Ronald Podolny, *Fixing What Ain't Broke: In Defence of Canadian Poison Pill Regulation*, 67 U.T. FAC. L. REV. 47 (2009).

172 *Id.* at 89.

173 *Cf. Blasius Indus., Inc.*, 564 A.2d at 651. However, as discussed above, Canada's statutory regime more effectively protects Canadian shareholders than does the United States'.

b. "All or Nothing" Proposal

Another proposal takes its inspiration from the U.K.'s requirement that any listed firm's shareholders each own either less than thirty percent of a firm's shares or one-hundred percent of them.[174] This rule would translate into an "all or nothing" takeover requirement: "acquirers must buy 100[percent] or stay away."[175] Its proponent argues that this option would not inhibit an active market for corporate control but would ensure a "genuine democratic accountability of corporate insiders."[176] Imposing accountability is important, as corporate insiders have a strong presence in Canadian board rooms and shareholder meetings, and undemocratic, dual-class share structures are relatively common in Canada.[177] Given the existing prevalence of institutional shareholders in Canadian corporations, it is possible that this proposal could have the beneficial results that its proponent claims. He adds a caveat to his proposal: Canada should ensure the independence of the boards of its institutional investors (specifically pension funds) from corporate influence.[178]

This proposal is not inconsistent with my proposal. The proponent's caveat is a positive development given the increasing importance of pension funds and other institutional investors as shareholders in Canadian corporations. The proposal itself is predicated on creation of a national securities regulator,[179] which requires action by Canada's Parliament. Enactment of such legislation would harmonize Canadian securities regulation, and would provide an opportunity to correct the too-broad public interest jurisdiction that provincial securities commissions currently use to intervene in hostile takeover situations.

174 Randall Morck, *Shareholder Democracy in Canada* 31, (Univ. of Alberta Sch. of Business Working Paper, 2010), *available at* http://www.business.ualberta.ca/RandallMorck/Research/~/media/University%20of%20Alberta/Faculties/Business/FacultyAndStaff/FSA/RandallMorck/Documents/Research/WorkingPapers/2010_11_14_Shareholder_Democracy_in_Canada.pdf.

175 *Id*. at 32.

176 *Id.*

177 Telephone Interview with Sean Farrell, McMillan LLP (Apr. 19, 2011).

178 Morck, *supra* note 150, at 32.

179 *Id.* at 31.

4. Concluding Remarks.

M&A activity is not always successful. Bids sometimes fail and parties sometimes terminate deals. Companies' post-merger performance sometimes disappoints. Determining which transactions are likely to disappoint and which are likely to create value for shareholders demands a high level of business acumen. Corporate law is built on the foundational principle that directors have this business acumen, and has created a law of agents and principals to ensure that director–agents exercise it in the best interest of the corporation and of the shareholder–principals who own it. Shareholders have recourse to the ballot box and to the courthouse where directors do not uphold their duties under corporate law.

Where the directors *do*—i.e., where they take informed action with good faith belief that the action is in the best interest of the corporation—courts and securities regulators alike should respect their decisions. It is not the place of the court or the securities regulator—just as it is not the place of the shareholder—to manage the corporation and decide the details of its business strategy. The decision to enter transactions that risk these negative outcomes should be entered into carefully and as part of a well-considered business strategy; by corollary, a well-considered business strategy to remain independent is one that should remain available to a board. Reflexively putting a company in play as soon as a hostile bidder makes his first bear-hug favours hostile bids and undermines that division of ownership and management that is the foundation of our corporate law. Instead, directors should be free—within the bounds of their fiduciary duties and disciplined by the ballot box—to determine the company's business strategy.

a. Analysis of M&A Activity

Currently it is too easy to take over a Canadian corporation. Canadian deals typically are "easier and less time-consuming to accomplish" than comparable American deals.[180] And, as in the United States, studies of post-merger performance of Canadian acquirors consistently reveal that mergers typically are not good for acquirors. One study in 2004 examined the long-term performance of acquiror securities in 267 consummated Canadian acquisitions that took place

180 *Cf.* Thomson et al., *supra* note 60, at A73.

between 1980 and 2000. The study concluded that "Canadian acquirers significantly underperform over the three-year post-event period".[181] Additionally, a study of post-announcement stock performance in 2000 referred to, without challenging, studies of corporate earnings that reveal a "declining average bidder firm performance during the two- to five-year period following merger announcements."[182]

The Canadian regulatory environment renders corporations much more vulnerable to these negative performance outcomes. Hostile bids in Canada historically have had a higher success rate than hostile American bids. In a 2004 comparative study, two Wharton School professors determined that Canada's success rate for hostile takeover bids was approximately thirty-five percent between 1988 and 1998, relative to a twenty-two percent success rate for such bids in the U.S. during the same period.[183] More recent data suggests that the Canadian success rate continues to be higher relative to the United States. Since 1998, the success rate for hostile bids for an American target has been approximately 27.6 percent. By contrast, the success rate for hostile bids for a Canadian target has remained considerably higher, approximately 35.6 percent.[184]

This success rate is equally applicable in non-hostile situations. In the United States,

> [a]lthough many corporate law scholars continue to obsess over the few cases in which corporate boards were able to keep their stockholders from accepting premium acquisition bids, the realities of the marketplace and the pressure that case law put on directors to act faithfully toward stockholders led to a huge increase in mergers and acquisitions activity.[185]

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181 Jean-Francois L'Her, *The long-run performance of mergers and acquisitions: evidence from the Canadian stock market*, 33 FIN. MGMT. 27, 27 (Dec. 22, 2004), *available at* http://www.allbusiness.com/personal-finance/investing-stock-investments/294218-1.html.

182 B. Espen Eckbo & Karin S. Thornburn, *Gains to Bidder Firms Revisited: Domestic and Foreign Acquisitions in Canada*, 35 J. OF FIN. & QUANT. ANALYSIS 1, 1–2 (Mar. 2000).

183 William D. Schneper & Mauro F. Guillen, *Stakeholder Rights and Corporate Governance: A Cross-National Study of Hostile Takeovers*, 49 ADMIN. SCI. Q. 263, 285 ("Table 1") (2004). The study found that of 88 hostile attempts in Canada during the period, 30 succeeded; compared to 97 of 429 American attempts.

184 Bloomberg LP (MA Equity database search), accessed Apr. 22, 2011 (defining as "hostile" those deals designated by Bloomberg as "hostile," "unsolicited to hostile," and "friendly to hostile.").

185 Leo E. Strine Jr., *Human Freedom and Two Friedmen: Musings on the Implications of Globalization for the Effective Regulation of Corporate Behaviour*, 58 U. TOR. L. J. 241, 260 (2008) (citing Marcel Kahan & Edward B. Rock, *How I Learned to Stop Worrying and*

This statement is even more applicable to data regarding general M&A activity in Canada. For example, of the 1,096 deals announced in 2010,[186] only seventy-two were terminated (fifty of which had a Canadian target).[187] Though it is likely that many of these aborted deals were hostile transactions (which account for a higher percentage of the total number of aborted deals)[188], that total number of aborted deals remains small as a percentage of all announced deals. These numbers account for the anecdotally-repeated fact that hostile bids almost always result in a transaction, either with the bidder or with a white knight. This always-on-firesale state of corporate Canada in fact is bad for shareholders, in light of the studies of post-merger performance.

b. Shareholders as Informed Corporate Citizens

Shareholders are not "suddenly wiser" in deciding how to vote in a proxy battle presenting the same issue as is presented to shareholders in evaluating a hostile bid. However, for the position of "director" to mean something, and for the concept of fiduciary duties to mean anything, there needs to be an at least symbolic protection of the directors' decisions on behalf of the corporation. If shareholders decide that the director's decisions are not in the best interest of the corporation, then they have options. Shareholders can sell their shares in the corporation that that director manages; there is no right to a premium but there is a public market for the shares. Or shareholders can vote that director out of office; shareholders have a well-protected right to decide who represents them.

Easy impeachment accomplishes the same constraining function (market for corporate control constraint) as a tender offer, but there is nothing about a tender offer that is so sacred that it should be protected and excluded from the traditional division between shareholder and

Love the Pill: Adaptive Responses to Takeover Law, 69 U. CHI. L. REV. 871, 873–80 (2002) and stating that the article "detail[s] the huge increase in mergers and acquisitions activity during the period from 1980 to 2000.").

[186] *M&A Quarterly Report – Q4/10*, CROSBIE & CO. INC., http://www.crosbieco.com/ma/index.html.

[187] E-mail from Yvonne Yip, PostMedia Network Inc., Apr. 5, 2011 (on file with author).

[188] *Are you a takeover target?*, DELOITTE & TOUCHE LLP, http://www.deloitte.com/view/en_CA/ca/insights/insights-and-issues/3a9ca68c4d101210VgnVCM100000ba42f00aRCRD.htm ("hostile bids have a termination rate of 56%, compared to 10% for friendly bids."). The Baffinland bid and the Lions Gate bid (discussed *supra*) and the BHP Billiton Ltd. bid all appear on the list.

director responsibility. This division respects the role of the director in making strategic decisions regarding the fate of the corporation—which should include the strategic decision whether to remain independent. Even if it is only symbolic and formalistic, directors should make that decision. Directors can be impeached for taking that position, and challengers can run on a platform of openness to unsolicited bids. In any event, directors should not be constrained in exercising their fiduciary duties by considerations imposed by a third-party administrative tribunal purporting to defend shareholder interests, where the existing statutory regime already protects those interests.