University of Alberta

A Comparative Analysis of the Legal Status of Hostile Take-Over Defence Mechanisms in the United Kingdom, Canada and the United States of America.

by

Terence Wesley Little ©

A thesis submitted to the Faculty of Graduate Studies and Research in partial fulfilment of the requirements for the degree of Master of Laws.

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Abstract

This thesis is a comparative analysis of the legal status of various hostile takeover defense mechanisms. The defenses themselves (such as "poison pills", "shark repellent corporate constitutions", "greenmail", and "white squires") are described in detail. Next, their legality is analysed in the following three common-law jurisdictions: the United Kingdom, the U.S. state of Delaware, and the Canadian province of Ontario. A cursory examination of the three jurisdictions' entire takeover environments and legal regimes is also performed. The thesis concludes with an analysis of what the British and American approaches "can teach Canada", keeping in mind the philosophical issues regarding shareholders' rights, the scientific data regarding the utilization of hostile takeover defenses, and some anecdotes from this area of the law.

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Chapter 1: An Introduction to the Issues, the Scope of this Thesis, Academic Opinion Regarding the Propriety of Defensive Actions by Target Management, and Choice of Jurisdictions for Comparison

1.1: Introduction, Scope, and Structure of this Thesis

This thesis examines the legal status of hostile takeover defense mechanisms from a comparative perspective. The second chapter is a detailed description of the various defenses themselves.

The third, fourth, and fifth chapters analyze the legal status of these various defenses in the United Kingdom, Canada, and the U.S.A.. The third chapter focuses upon the British approach to this area. As a unitary state, it is obviously the law of all of the United Kingdom which is examined. As well, both the extra-judicial City Code, and the listing regulations of the London Exchange are dealt with. The chapter dealing with the Canadian regulatory and legal regime focuses primarily upon Ontario securities law, both Ontario and federal corporations law, and the by-laws of the Toronto Stock Exchange. Chapter five deals with the American approach; using Delaware corporations law and the listing rules of the New York Stock Exchange as models for the American position. U.S. federal securities regulation is also discussed.

Each section in which I analyze the legal status of these takeover defenses follows the identical format. Firstly, the general legal rules which govern the ability of target management to engage in hostile takeover defense mechanisms is discussed. Then, following that sub-chapter is an analysis of any specific caselaw, or regulatory rules, or statutory rules that deal with, or affect, any particular defense. Chapters three through five terminate with conclusions regarding the respective legal regime's approach to the regulation of the utilization of hostile takeover defenses by a target company's directorship.

The sixth chapter is an analysis of the reasons for the differing status of the law in each of the three jurisdictions; that is, a cursory analysis of the fundamentals of the overall takeover regimes, as well as the takeover environments, in all three jurisdictions which are the subject of examination. That is because one can not understand the dramatically divergent treatment of hostile takeover defenses in the three countries without understanding the "entire takeover picture".

Chapter seven, the final chapter, is a conclusion. I discuss: anecdotal evidence regarding the financial and corporate-efficiency effects that the usage of hostile takeover defense mechanisms has on a corporation, theoretical models regarding whether defenses should be permitted, a summary of the empirical evidence regarding hostile takeovers in general, and the philosophical issues regarding the regulation of hostile takeover defenses (i.e. shareholders' collective right to determine whether or not to sell their shares).

The final sub-chapter is a discussion of what, in light of the anecdotal evidence, philosophical issues, theoretical arguments, and scientific data, the other two legal systems "can teach Canada". I will argue that, with several minor exceptions, Canada has more or less "got it right"; avoiding most of the pitfalls that plague both American and British regulation of this area of the law of corporations.

<u>1.2: Propriety of Management Engaging in Hostile Takeover Defenses: The Two Major Schools of Academic Opinion</u>

1.2(a): Hostile Takeovers: A Definition

A hostile takeover is an attempt; either by way of proxy battle followed by a proposal to engage in a friendly merger with the acquiring entity, or gradual market accumulation of shares, or tender offer, or a combination of same; to take control of a corporation either without the present management's consent, or against its downright opposition[1]. There are two major schools of thought in regards to the propriety of a corporation's present management actively resisting a change in corporate ownership.

1.2(b): The "Free-Reign" for Target Management School

Martin Lipton[2], a New York City-based mergers and acquisitions lawyer whose sub-specialty is helping target companies fight off unwanted takeovers, is the leader of this school of opinion. He argues that management of the target company should have a relatively free reign in utilizing corporate resources to battle a corporate takeover if, and only if, the directorship has reasonable grounds to believe that it is not in the best interests of the company to undergo that specific, or any other, change in control.

His premise is based on the notion that a change in the control of a company is no different from any other business decision faced by a corporation's senior management, and thus should be afforded the protection of the "business judgment rule" - a rule that is highly deferential to the decision-making of a company's directorship.

1.2(c): The "Managerial Passivity" School

The other major school of thought is based on a law and economics analysis, and holds that target management should be totally passive when responding to an unsolicited offer to alter the ownership structure of a company. It is most closely associated with Professors Easterbrook and Fischel who offer three principal arguments in support of their position[3].

Firstly, that corporate shares will, as a general rule, only be undervalued[4] (and the corporation thus attractive to takeover) if the corporation is being poorly run by the present management team. Thus, the threat of being taken-over (and not being highly-paid managers any longer) is good "discipline" for the management of companies. They view this as being especially important in an era when the ownership and both the legal and effective control of companies is highly separated.

Secondly, the two authors argue that directors and senior executives of a company have an inherent conflict of interest at stake during any takeover battle. That is, the following question will always be lurking in the minds of any disinterested observers of a target company's management who are attempting to fend off an unsolicited offer to change control: "Are the directors resisting the takeover because they honestly feel it is in the best interests of the company and its shareholders to do so, or because they fear that they will no longer continue to be directors and senior officers of that corporation after the proposed change in control?".

And thirdly, that the market should govern the ownership of companies. Therefore, any usage of hostile takeover defenses is "interference" in the marketplace - a market that the two authors assume is efficiently operated by a society composed of "rational wealth maximizers".

Another argument against permitting takeover defenses to be used is philosophical, and is expressed in court decisions such as Hogg v. Cramphorn[5]: that is, that the very principals of democracy itself are at stake. This argument puts forth the notion that shareholders own the company; thus, they, and only they, should be permitted to decide whether to sell their shares to an entity who makes an unsolicited bid for control. It is thus considered to be grossly improper for a bunch of corporate bureaucrats to be able to thwart the shareholders' plans because of their personal opinions as to who the best potential owners of the company would be, or whether the offer to the shareholders is "adequate".

1.3: Reasons for the Choice of Jurisdictions for Comparison

Deborah DeMott[6] notes that hostile takeovers are virtually non-existent in all but four countries in the world: the United States of America, Canada, the United Kingdom, and Australia. The four countries' relevant common characteristics which she argues are responsible for this situation are as follows: a relatively large number of widely held, publicly-traded companies; relatively little control (by international standards) of mergers and takeovers by the government; statutory provisions, and/or stock exchange listing regulations, which place severe limitations on the ability of publicly-traded companies to prohibit, or severely limit, share transferability; and, the relatively limited cross-ownership of shares among major corporations in these four countries.

The reasons that I am limiting the scope of this thesis to analysing the three forementioned jurisdictions are multifarious, and are as follows:

Of the four forementioned nations, the three countries in which the overwhelming majority of hostile takeovers take place are: the U.K., Canada, and the U.S.A.[7].

Ontario was chosen as the model jurisdiction for Canada due to: the overwhelming prominence of the Toronto Stock Exchange[8], the overwhelmingly large number of Canadian companies incorporated in Ontario[9], and the fact that Ontario's securities and corporate law legislation is used as a model for Canada's other eight common law provinces[10]. As well, the federal enabling statute for corporations will be examined. As will be seen, its provisions closely mirror those of Ontario.

As stated, since Britain is one of the three jurisdictions in which hostile takeovers are most prevalent, I analyze British law[11]. Also, its legal traditions form the foundation for the other two legal systems that are the focus of my analysis. The only stock exchange in the United Kingdom is the London Stock Exchange[12]; its listing rules will be focused upon in so far as they affect the employment of hostile takeover defenses by the management of a company listed on same.

Due to the large number of American companies incorporated in Delaware (over 50% of all American public companies), and the fact that other states model their corporate law on Delaware's, and the fact that over 50% of all New York Stock Exchange (NYSE) companies are incorporated in Delaware[13], and the fact that the NYSE is America's leading exchange[14]; the focus will be on Delaware corporate law and the regulation of the New York Stock Exchange.

Chapter 2: Defense Mechanisms: An Overview[15]

2.1: Introduction to Defensive Measures

There are two basic forms of defensive tactics: general and specific. General defensive tactics are designed to discourage any individuals from launching a takeover bid in the first place. An example of these are "shark repellent" charter amendments. Specific defenses are ones which are launched while an actual bid is underway and are designed to thwart that particular bid. Many of the following defenses can be used either as general deterrents to takeovers, or as a response to a particular bid which management views as unwelcome (a specific defense).

2.2: Shark Repellents

The term "shark repellent" refers to any clause in a corporate constitution whose inclusion has as its objective or practical effect the making of a takeover more difficult, expensive, time-consuming, or complicated. The theory being that the "shark" (takeover artist) will seek prey, in the form of another company, elsewhere.

2.2(a): Fair Price Provisions

These are designed to prevent the coercive and abusive tactic known as the "two-tier front-loaded takeover". In these bids, those shareholders who tender their shares at the initial offering receive significantly higher consideration than those who are "squeezed-out" later on. These provisions in a corporation's constitution guarantee that those shareholders who are "squeezed-out" at the second stage of the takeover (the going-private phase) receive identical consideration in comparison with those individuals who tendered their shares earlier on.

The protective nature for the stockholders is that these remove any potential coercive elements out of a tender offer. That is, the compulsion to tender shares for an inadequate offer out of a fear that one will be forced to accept the consideration which will be paid for the shares at the second stage of a two-tier bid - assuming enough of the other shareholders tender at stage one.

The defensive nature is that these amendments have a practical effect in that they cause a corporate takeover to be more costly as the acquiring entity will have to advance identical (presumably higher) consideration to all shareholders.

2.2(b): Staggered Boards of Directors

These slow down "creeping acquisitions" whereby a shareholder gradually accumulates enough shares to vote himself, or allies, in as directors - thus having effective control of the company. Since only a certain percentage of directors come up for re-election each year, the raider must either make an all-cash bid for all shares to take instant control of the corporation, or wait several years before assuming control.

Also, these provisions often prohibit the removal of any director before the expiration of his or her term except "for cause".

2.2(c): Limitations on the Ability of a Shareholder to Call a Special Meeting

These amendments guarantee that any formal proxy contests only occur at an annual meeting, unless the board agrees to permit the special meeting. This "slows down" the takeover artist; giving target management time to coordinate and plan a response.

2.2(d): Separate Classes of Shares

This consists of various forms. However, the concept is to consolidate power in the hands of management-held shares.

One version involves having the power to issue separate classes of shares which differ in that each class would get to elect its own director, and not actually exercising this power, but merely threatening to do so in the event of a takeover. A second form allows investors to trade in shares which are voting for non-voting ones which yield a higher rate of interest, while management presumably holds onto their voting shares and consolidates their power base (this is a "dual-class recapitalization").

2.2(e): Weighted Voting Clauses & Super-majority Provisions

Conceptually, the variations of these charter amendments are limitless. However, there are three major types of these provisions.

Super-majority clauses are self-defining: certain amendments to the corporate constitution (invariably the "shark repellent" clauses), and certain shareholders' resolutions (for example, approving a merger), require astronomical majorities of up to eighty or ninety per cent to be passed.

The first type of "weighted voting" involves issuing separate classes of shares with increased weight attached to the shares which management and its allies control.

Another version involves limitations on the maximum votes any one shareholder may exercise. For example, one may be limited to 1000 votes no matter how many shares that individual holds.

2.3: Share Purchase Rights Plans (Poison Pills)[16]

There are three versions of New York mergers and acquisitions lawyer Martin Lipton's infamous "poison pill": the flip-over plan, the flip-in plan, and the back-end plan.

2.3(a): Operation of the Plans

The fundamentals of all three plans are that all common shareholders of the corporation are distributed one "right" per share as a "special dividend". The corporation's directors retain the right to redeem (i.e. revoke) these rights at any time for a nominal sum. These rights trade with the shares and are not exercisable until a "triggering event" occurs. This event is either defined as the acquiring of a certain percentage of the corporation's common stock by any one individual, or the announcement of a tender offer by any person (the acquiring entity). Upon occurrence of the "triggering event", the rights detach from all the shares held by the acquiring entity and become null and void (this is the "poison"). Also at this stage, the rights themselves (the share options) can be sold and traded freely - except of course for the rights which were attached to the shares held by the individual who caused the "triggering event" to occur.

2.3(b): *Flip-in & Flip-over Plans*

The flip-in and flip-over plans are the two basic forms of the forementioned share purchase scheme. They are similar with the only distinguishing feature being that flip-in plans permit the rights to be exercisable if an acquiring entity merely exists, rather than only becoming exercisable once there is an actual merger with the acquiring entity. That is, a flip-in plan defines a "triggering event" more broadly to permit the rights to become exercisable once a tender offer has been announced, or an individual has purchased a significant minority stake in the company. In contrast, a flip-over plan is only exercisable once the corporation has actually been taken-over. The rights of either plan permit the holder of same to effectively purchase newly issued shares in the target company at half-price; thus dramatically diluting the takeover artist's relative share position.

The effect is evident - the putative acquirer's relative portion of the target's shares has been reduced dramatically. This makes a takeover prohibitively expensive. The exception is that if the acquirer negotiates with target management and gets them to agree to redeem the rights; thus putting an end to the plan.

2.3(c): Back-End Plans

A back-end plan is quite different in that it allows the rights holder to exchange their shares for a package of debt obligations in the target (corporate debentures) which are equal in value to the long-term value of the company. That is, the "special dividend" in the form of a "right" is not a conditional option to purchase shares at a fire-sale price. Rather, it is a special dividend in the form of a "right" to exchange, at a favourable rate, any shares held in the company for corporate debentures in that same company.

It does not dilute the acquirer's relative share portion like a traditional "poison pill". But rather, it has the effect of raising the price of each share to reflect the "true" value of the corporation. A second effect is that the company would be less desirable as a target because it would be awash in debt after any takeover in which management did not first redeem these "rights".

2.4: Change of Control Contracts

2.4(a): Golden and Tin Parachutes

These "parachutes" are clauses in the contracts of employment that provide for incredibly generous levels of severance pay in the event that the employees are terminated following a "triggering event". This event is virtually always defined as a change in ownership control of the company. The ostensible purposes of these are twofold:

Firstly, to ensure continuity of staff during a takeover. That is, to prevent the senior executives (the receivers of the "golden parachutes"), as well as the junior executives right down to the staff who sweep the target company's office floors (the individuals receiving less generous "tin parachute" protection), from resigning to seek employment elsewhere. This would presumably take place because the employees fear for their future employment prospects at the target corporation after a takeover.

And secondly, that they are necessary to attract quality employees to firms which are likely to be taken-over at some future time. The deterrent effect in regards to hostile takeovers is obvious: these clauses ensure that a corporate raider who is interested in a liquidation of the corporation's assets, and resulting lay-off of the target company's staff following a takeover, will face financial impediments that may make a "bust-up raid" economically unfeasible.

2.4(b): Pension Parachutes

These are clauses in a pension agreement that cause all excess moneys in an over-funded pension scheme to immediately vest in the fund upon any individual assuming control of a determinate percentage of the company's stock without the prior approval of the corporation's management. These have two purposes.

The first purpose is that they may make a takeover prohibitively expensive unless the potential acquirer negotiates with, and ultimately receives the approval of, target management. The second purpose is altruistic. That is, to protect the pension plans of employees who work for a socially responsible company.

2.5: Poison Puts

These are clauses which the corporation has inserted in basically every contract it has with anyone and everyone. They allow the other party to call a loan or cancel the contract at its sole discretion if there is a significant change in either the ownership structure or management of the corporation. The "theory" behind these types of clauses is that the other party to the contract has entered into the agreement partially on the basis that they have significant faith in the present ownership and management team.

The result is that the acquirer of the company risks substantial uncertainty upon his or her assumption of control as every contract with that company is called into question. When the contract in question is a loan agreement the nickname for this type of clause is "poison debt".

2.6: Restructuring Defenses

These basically involve changing the company in ways that either: a)provide the shareholders with a superior financial return in comparison with what they would receive from selling their shares to an acquiring entity, or b)alter the company in ways that make the company unattractive to the bidder.

2.6(a): Sale of the Crown Jewels

This involves selling off assets which either the bidder, or the market, consider to be invaluable to the corporation.

If the bidder wishes to purchase a company so that it may acquire asset "x", and the company knows that and thus sells "x" to someone else; the theory holds that the acquiring entity will then either give up or try to buy a controlling interest in that "someone else".

If it is an asset which is extremely valuable to the corporation and it is sold off, this will make the corporation less valuable, so that an acquirer will have to pay a higher interest rate on any "junk bonds" issued to finance the buy-out, assuming it is a leveraged one.

2.6(b): Corporate Split-ups & Spin-offs

This is the flip-side of selling the "crown jewels". This technique involves a fire-sale of corporate "losers" (under-performing assets, money-losing subsidiaries, etc.) to leave a leaner, meaner, and more profitable corporation that is hopefully so desirable that the shareholders would never wish to sell their shares to a person seeking to assume control of the company.

Or, the company may sell-off a profitable sub-division with the hope of focusing market attention on the company's stock. Theoretically, this should drive the stock price up enough to make a takeover too costly.

2.6(c): Self-tendering of Shares

This is basically an offer by a corporation to buy shares in itself. The defensive aspects are several. One is the subsequent consolidation of control by management, as the directors (the corporation's agents) would then control the votes attached to those shares.

A second effect is that the corporation would be less "liquid", or possibly even burdened with a large debt-load used to finance the self-tender. Obviously, this would make the corporation much less desirable to the acquiring entity.

2.7: White Squires/Knights and Lock-ups

This is one of the more frequently used defenses, and the one which has in the past been responsiclefor much of the litigation in the field of anti-takeover devices. There are two basic forms.

2.7(a): Share Issuance to a "Puppet"

This involves issuing stock to a friendly party who can be expected to vote their securities in accordance with management's wishes. Often a contract is entered into which specifies the manner in which the "white squire" is to vote his or her shares.

2.7(b): Lock-ups

Getting the "white squire" to agree to come to the "rescue" of the target company, through the purchase of newly-issued securities and entrance into a voting contract, often involves entering into a contract called a lock-up. It usually guarantees the "white squire" either the right to buy a corporate "crown jewel" at a favourable price, or an option on authorized but yet unissued stock.

2.7(c): Friendly Merger

This involves management seeking out a company which they believe would either be a better owner than the unsolicited raider, or be willing to advance superior consideration to the target's shareholders.

2.8: Litigation

This defense involves suing the potential acquiring entity - the claim almost always being that anti-trust or takeover statutes are not being complied with.

2.9: Defensive Acquisitions

The target company may decide that the best way to fend off an unwanted offer is to purchase an asset that has one of two effects.

2.9(a): Making the Company Less Valuable

The first effect this may have is that this may make the company less valuable. An example is where the target company purchases shares in another company which is in financial difficulty. The intention is twofold: make the acquiring entity no longer want the target company as it is not as valuable; and if the takeover is leveraged through the debt market ("junk bonds"), the corresponding interest rate would raise and make a takeover unprofitable.

2.9(b): The Creation of Regulatory Hurdles

The second effect is that regulatory hurdles may be erected. This is especially true in regards to anti-trust laws. An example would be as follows: say that Boeing tried to take over Southland Corporation (7-Eleven's parent); Southland may decide to purchase 10% of the stock in McDonell Douglas Aircraft. Boeing could then possibly become illegible to take legal control of Southland due to anti-trust regulations. At the least, it may have to seek long and protracted regulatory approval.

2.10: Greenmail

This involves target management self-tendering (buying back shares in itself), at a premium, the stock of the raider him or herself. This would be accompanied by a covenant in which the raider agrees to never again purchase stock in the target company (a "standstill agreement"). The danger of this strategy is obvious: it may encourage people to buy stock in a company and threaten takeovers without having any real intention of actually buying the company. That is, "greenmailing" companies could become, and actually has become, an end in and of itself - a very costly end that is!

To try to reduce such payments to "greenmailers" (individuals whose intention was never to actually stage a takeover, but to get bought out at a premium), many companies have introduced "anti-greenmail charter amendments". These provisions basically prohibit the self-tender of the corporation's stock at a certain price unless the shareholders, excluding any votes exercised by the "greenmailer" him or herself, vote to permit such a purchase.

2.11: Pac-Man

In this defense, the target of the hostile bid launches a takeover bid for the acquiring entity, effectively "turning the tables" on it, and "eating you before you eat me" (hence the nickname "Pac Man").

2.12: Increasing Dividends

By announcing an increased or special dividend, the share price may increase substantially so as to make a takeover prohibitively expensive. As well, the company becomes less liquid, and therefore less valuable to the raider.

2.13: Cross-Ownership

This is almost like a form of advance, mutual "white knight" or "white squire" arrangement. An example is the Torstar/Southam alliance. The way it works is that company "x" issues a large block of shares to a friendly company (company "y"); company "y's" consideration for company "x's" shares is to issue an identically valued block of shares to company "x" in return. This is accompanied with a voting agreement in which company "x" agrees to vote the shares it has in company "y" in accordance with company "y's" wishes, and vice versa.

2.14: Takeover-Proof Mergers

This involves entering into a friendly merger agreement that includes either a lock-up provision for stock in the entity, or a liquidated damages clause; both of which are triggered if the merger fails due to a hostile bidder winning out. As well, the contract may contain an agreement by the directorship of the company initiating the friendly-takeover in which it is promised that no alternative bids will be solicited (a "no-shop clause").

2.15: Management-Led Leveraged Buy-Out (MLBO)

A management-led, leveraged buy-out is not technically a defense because there is not an actual change in corporate control, but merely a strengthening of the present control. In short, it is the purchase of the corporation by members of the corporation's management team using borrowed funds, funds which are borrowed using the corporation's assets as collateral for the loan. When used in the context of a takeover battle, it is a sort-of "white knight agreement" in which the "white knights" who ride to the rescue of the company are the target company's own directors.

2.16: Conclusion

While the defenses come in various forms, to which are attached the most exotic of vocabularies, the essentials of all of the forementioned strategies are identical. The mechanisms all either: increase either the share price or the number of shares an acquiring entity will have to purchase to take control, and thus the cost of the takeover; make the take-over process more protracted and complicated; make the company less valuable; offer the shareholders a superior return in comparison with selling to the raider; or (as in the case of "greenmail"), offer the raider a "bribe" to go away and leave the company alone.

Chapter 3: The British Approach to Defensive Actions

3.1: The General Rules Regarding Defensive Actions

The starting point for any discussion of British law as it applies to the utilization of defensive tactics by target management is the so-called "proper purpose test". In short, the basic judicial rule in the United Kingdom used to be that target management was virtually debarred from engaging in defensive actions when confronted with an unsolicited and undesired bid for a change in control. However, this approach has been somewhat softened in recent years, and it is now an open question in regards to whether the managers of British companies are still virtually prohibited from utilizing hostile takeover defenses.

3.1(a): Historical Roots of the "Proper Purpose" Test

Punt v. Symons & Co., Ltd.[17] is one of the first pronouncements by the British courts regarding the propriety of management issuing shares with the sole purpose being to alter the balance of power among the shareholders. Note that this case does not actually deal with target management issuing shares to a "white knight".

The facts of this 1903 case are as follows: The directors of a company believed that passing a certain special resolution would be beneficial for the company. The directors and their allies did not have the requisite shareholder support to pass this resolution. Therefore, the directors issued shares to some individuals who could be expected to vote in accordance with themselves. The dissenting shareholders applied for, and were issued, an injunction to prevent this share issuance.

The court's reasoning is as follows: directors may only issue shares for a "proper purpose". Generally, the only proper purpose is to raise capital, or for any other reason which is "for the benefit of the company". Mr. Justice Byrne, at page 528, states:

> "...; but when I find a limited issue of shares to persons who are meant and intended to secure the necessary statutory majority in a particular interest, I do not think that is a fair and *bona fide* exercise of the power."

This case set the stage for many subsequent cases which dealt with share issuances to "white knights". The court seems to accept, as self-evident, that it is impossible by definition for the alteration of voting power among shareholders to ever be for the advantage of, or to the benefit of, a company.

The learned justice is clearly worried about the philosophical issue of shareholders' democratic rights. The judgment mentions the share issuance being not for the benefit of the company, but rather being "solely to acquire an undue and unfair majority.".

The case of Piercy v. S. Mills & Co.[18] is the first chancery division case which dealt with a share issuance which was designed to alter the balance of power so that an individual who had acquired majority control of a company would be "frozen out" and reduced to a minority shareholder.

The individual who had become a majority shareholder wished to use his voting power to elect himself a director of the company. The two present directors considered him to be grossly unsuitable; being afraid that he would destroy the company (he had made clear his plans to attempt to put the company into liquidation if he succeeded in assuming control of the board of directors). The directors issued shares to themselves and to several friends with the sole intention being the dilution of the plaintiff's voting power.

The plaintiff appealed to the court to set aside this share issuance on the grounds that it was a breach of fiduciary duty. The court did this, even though the court accepted that he was an unsuitable candidate, and that the directors had reasonable grounds to believe that it was in the company's best interests for him to not become a director.

Again, the court seemed to be pre-occupied with one issue: shareholders' democracy. The court stated that issuing shares for the sole purpose of overriding the wishes of the majority is always illegitimate. And therefore, it was, almost by definition, a breach of fiduciary duty. The court was unwilling to accept that the best interests of the corporation could ever require an overriding of the wishes of the majority of the shareholders as "a company is its shareholders". Therefore, logic dictated that this act could not be a valid exercise of managerial discretion.

Like the two forementioned cases, the following one does not specifically deal with the issue of target management engaging in a defensive manouevure to block a hostile takeover. Rather, it deals with a related issue.

The Rights and Issues Investment Trust Ltd.[19] case concerns a company in which the management-owned shares controlled 47% of the voting power. The company was negotiating with another company to acquire the assets of that other company. The consideration for this deal was to be an issuance of authorized, yet previously unissued shares. Management did not want their voting power to be diluted. Therefore, they requested that all of the other shareholders vote on a measure that, if passed, would increase the votes attached to management-owned shares. This would allow management to still control 47% of the votes after the share issuance. Management did not vote at either of the two shareholders meetings during which this measure passed overwhelmingly.

A dissenting shareholder requested that this alteration of the votes which attached to the shares owned by management be set aside under the oppression remedy. The court declined.

The ruling accepted that this alteration in voting power could be justified as a matter of business policy "...provided that the resolution was passed by a majority [of the shareholders] with no personal interest in the matter....".

This *ratio decidendi* may suggest that if management were to attempt to discourage a hostile takeover through management consolidation of voting power, and this consolidation was approved by a majority of shareholders at a meeting in which management abstained; that this would be acceptable.

Note however, that this case's fact pattern did not deal with an attempt by management to increase their power, but only to maintain it after a share issuance which was undertaken in the normal course of business.

3.1(b): Hogg v. Cramphorn & the Modern Proper Purpose Test

In the 1960's the leading British authority was handed down regarding the propriety of target management engaging in hostile takeover defenses. The case of Hogg v. Cramphorn[20] made it very clear that target management had virtually no ability to engage in defensive manoeuvres to thwart an undesired takeover bid, and that any attempt to do so would be treated as a *de facto* breach of fiduciary duty.

The directors were confronted with an attempt by an individual to seize control of the corporation by purchasing a majority of the shares. The directors issued 5,707 shares, with 10 votes attaching to each share, to a trust which they had set up for the employees. The managing director and two friends were appointed trustees of same. The evidence was clear that this was done with the sole intention of diluting the voting power of the individual who was attempting to take the company over.

The court accepted that the directors believed that this takeover was not in the best interests of the company. It also accepted that the directors had at all times acted in good faith. However, the court set aside this share issuance as a breach of fiduciary duty. The court reasoned that any action designed to "thwart the will of the majority" was inherently illegitimate. This was so even if the directors had good reasons on which to found a belief that a change in control was not in the company's best interests.

This case reflects a rigid view of fiduciaries that seems to accept that it is impossible, on a conceptual level, for it to ever be in a company's best interests to have the will of the shareholders thwarted in any way.

The English Court of Appeal took advantage of the opportunity provided by the case of Bamford v. Bamford[21] to both re-affirm the rule in Hogg v. Cramphorn, and to add a gloss over it. The factual situation involved a share issuance whose purpose was to block a hostile takeover. The learned Harman, J. stated:

> "So it seems to me here that these directors, on the assumptions which we have to make, made this allotment [of shares] in breach of their duty - *mala fide*, as it is said. They made it with an eye primarily on the exigencies of the take-over war and not with a single eye to the best interests of the company, and therefore it is a bad allotment; but it is an allotment. There is no doubt that they did allot them. There is no doubt that the allottees are on the register and are for all purposes members of the company. The only question is whether the allotment, having been made, as one must assume, in bad faith, is voidable and can be avoided at the instance of the company - at their instance only and of no one else, because the wrong, if wrong it be, is a wrong done to the company. If that be right, the company, which had

> the right to recall the allotment, has the right to approve of it and forgive it;....(at page 972-973)

This case made it clear that British courts still considered it to be an almost automatic breach of fiduciary duty for a director to issue shares with the sole motivation of same being the blocking of a takeover bid. However, it also permitted these share issuances to "white knights" to be treated as merely voidable by the courts, rather than being treated as void *ab initio*. The judgment made it clear that a share issuance initiated as a defensive action to a hostile takeover could be employed, and would not be interfered with judicially if, and only if, the shareholders ratified this "breach" of fiduciary ethics.

Howard Smith Ltd.[22] followed less than a decade after the Hogg case and further refined the test somewhat.

Two companies separately owned minority interests in Millers Ltd.. These two companies made it clear that they intended to begin to vote their shares in Millers Ltd. as a block; thus, this newly formed consortium would have *de facto* control of the company. The directors opposed this; responding by entering into a "white knight agreement" with Howard Smith Ltd. This effectively reduced these two blocks of shares, which had previously co-formed a majority, into a minority. The dissenting shareholders asked the Supreme Court of New South Wales to set this share issuance aside on the grounds that it was a breach of fiduciary duty. It acquiesced. Howard Smith Ltd. then appealed to the Privy

Council.

The Privy Council held that, on these particular facts, the share issuance was invalid as an improper exercise of the powers conferred upon the directors of the company. This was because the law lords viewed any share issuance whose primary purpose was to alter voting power to be an illegitimate act which constituted a breach of fiduciary duty.

The judgment held that even if it could be proved that the directors were not motivated in any way by self-interest (such as a fear that they would not be directors anymore, or out of a desire to strengthen their own voting power), and honestly believed that this change in voting power was for the benefit of the company, it was an improper exercise of directorial discretion.

The law lords then proceeded to refine Hogg. Firstly, by noting that it is possible for shares to be issued for a reason other than to raise capital, and for that issuance to still be a valid exercise of directorial discretion. And secondly, the law lords clarified that the mere fact that directors benefitted from a particular course of conduct did not invariably lead to a finding that there was a breach of fiduciary duty.

The law lords also mentioned, with approval, the Canadian superior court trial decision in Teck Corp. which is discussed *infra*[23]. As will be seen in the following chapter, this is an odd feature of this decision because the reasoning of the

British Columbia Supreme Court in Teck Corp. appears to be at such odds with this holding; actually going so far as to expressly reject the reasoning in Hogg v. Cramphorn on which Howard Smith Ltd. is based.

3.1(c): Duties of Directors During Contested Takeovers

The Heron International Ltd.[24] case deals with the duties of directors during contested takeover bids. The court holds that directors have only one goal - securing the best share price for the shareholders. The corporation's directorship may not consider any other factors, as "the interests of the company are the interests of the current shareholders".

By implication, one could argue that, while as a general rule hostile takeover defense mechanisms are prohibited, that this decision would permit, or even require, them to be used where the sole motivation of the directors was to secure a higher-priced bid by causing a "share auction" (delaying one bid through the usage of defenses while a higher-priced one is seeked out).

The case of Re a Company[25] was handed down four years after the Heron International Ltd. case. It dealt with similar facts; except that in this case, the rival bid, which was vastly lower, was a management-led one. The Court of Chancery distinguished the Heron International Ltd. case by noting that in that case the directors had actively blocked the shareholders from receiving the best bid, but that in this case the directors had "merely" not informed the shareholders about the details of a rival bid.

It appears that the Court of Chancery is classi. ing the statement from the Court of Appeal in Heron International Ltd. regarding directors being under a positive duty to get shareholders the best possible share price, as being mere *obiter dicta*.

3.1(d): Towards A More Flexible British Test

The Court of Appeal severely limited the approach taken in Hogg v. Cramphorn with its decision in Cayne v. Global Natural Resources PLC[26]. It holds that directors who engage in hostile takeover defenses will only breach their fiduciary duties if their primary reason for doing so is to maintain control of the company. If however, it is done for another reason, with the best interests of the corporation always at the forefront, then it is permissable. This is a sharp departure from the old doctrinaire approach which held that: "use of hostile takeover defenses = bad faith".

This was a welcome departure as it recognized that a change in control may not always be in the best interests of a company. It also recognized that corporate directors must defend the corporate entity from threats no matter what the source, even if that source is a change in control.

The Scottish Court of Session (Outer House) abandons, once and for all, the old "proper purpose test" with its decision in Dawson International PLC. v. Coats Patons & Ors[27]. It holds that a company, through its directors, has an interest in a change of control and that it can be beneficial for a company to be taken-over by one bidder rather than another. The judge accepts that the directors have a primary fiduciary obligation to the corporation. And therefore, that their duty is not to get shareholders the best share price, but to get the company taken-over by the most suitable suitor.

3.1(e): The Current Status of British Law

In conclusion, it is obvious that the English caselaw regarding the ability of target management to engage in hostile takeover defenses is in both a state of flux, and a state of uncertainty.

The law in the United Kingdom has clearly changed to be more flexible regarding the defensive actions of directors who find themselves faced with a takeover bid that they do not feel is in the best interests of the company. This is a welcome development that truly allows directors to act with a view to the best interests of the company, and not solely with a view to shareholders who wish to unload their stock for maximum short-term return.

The British courts have also finally recognized that a change in control of a company may not be in the best interests of that company.

However, due to the contradictory nature of the various precedents, and the fact that there are only two cases which take a more flexible approach, and the fact that the Howard Smith Ltd. case is a Privy Council decision, it is an open question regarding how much the British law of fiduciaries has changed on this point.

Another factor which confuses the issue is s. 309.1 of the Companies Act, 1985[28] which states that directors are "to have regard" to the interests of the company's employees. The following issue is raised: if a corporate raider were seeking to purchase a company, and s/he had a history of poor labour relations and/or was intending to liquidate the corporation's assets and lay off the present employees; would this section of the act permit, or even require, that the directors fight off the takeover bid? Related to this is the fact that an EU Directive specifically protects workers after a change in control[29].

3.2: Statutory Provisions Dealing With Particular Defenses

3.2(a): Special Majorities to Remove Directors/Staggered Boards

Section 303 of the Companies Act, 1985 permits a director to be removed by ordinary resolution, at any time during his or her tenure, regardless of anything to the contrary in the corporation's memorandum and articles. This statutory provision would obviously render any "staggered boards" or "special majorities to remove a director" or "removal of directors for cause only" provisions meaningless.

3.2(b): Limitations on a Shareholder's Ability to Call a Special Meeting

The Companies Act, 1985[30] prohibits any limitations on the right of a shareholder to call a special meeting. This would prevent the use of this "shark repellent" tactic which is used to delay any putative proxy battles.

3.2(c): Self-Tendering of Shares

In the United Kingdom, a company may only purchase its own shares provided two situations are present. Firstly, they are redeemable shares, and it is specifically authorized by the company's memorandum and articles[31]. The only other case in which it is permitted is if the corporation is attempting a reduction of share capital[32]. However, it must disclose this self-tender to the shareholders[33]. Generally, there is a blanket prohibition on a company owning its own shares[34].

Therefore, a corporation in England is debarred from defending against a hostile takeover by accumulating its own shares to be voted by the management in a block, presumably against any shareholders' resolutions introduced by a raider.

There are no provisions in the Companies Act[35] which prohibit the selective self-tender of shares, in either a Unocal-situation[36] or in a "greenmail" situation. However, as noted, the ability to engage in self-tendering of shares is severely limited in the United Kingdom.

3.2(d): Different Classes of Shares

The issuance of different classes of shares (i.e. different number of votes attaching, right of a class to nominate its own director, etc.), and the variation of the rights that attach to shares is permitted by the Companies Act, 1985[37]. And, while the London Stock Exchange does not refuse to list shares with differential voting rights, it does refuse to list shares issued by companies whose shares include restrictions on share transferability[38].

3.2(e): Issuance of Shares to a White Squire

By statute[39], a company may not issue shares unless it is authorized to do so in a general meeting of the shareholders, or it is provided for in the company's memorandum and articles. This authority can be a standing authority, but shall automatically expire after five years. This is obviously a severe limitation on the ability of directors to enter into a "white squire agreement" when faced with a hostile takeover.

3.2(f): Special Majorities

The articles of a British company may only be amended by special resolution[40] - defined as a resolution passed by 75% of eligible votes[41]. The Companies Act, 1985 does not contain any provisions which prohibit a unanimous shareholders resolution, or a provision in the corporation's articles, to provide for majorities of above the normal 50% among the shareholders to pursue any course of conduct[42]. Therefore, a charter provision of this type would be permissable.

3.2(g): Parachutes

Directors are permitted to receive severance packages. However, there are statutory limits placed on this ability[43]. This is an obvious limitation on the ability of directors to receive "golden parachute" protection in their capacity as directors.

It is likely that the forementioned s. 309(1)[44], which requires the directors to "have regard" to the company's employees, could be used to justify moderate "tin" and "pension parachute" protection for the company's employees. This is due to the fact that the purpose of these is not only to "raise" the cost of a liquidation raid, but also to protect employees who are employed by a socially responsible company. As well, the decision in The Taupo Totara Timber Co. Ltd. v. Rowe is applicable.

In regards to "golden parachutes" for the senior executives of a corporation, the Privy Council decision in The Taupo Totara Timber Co. Ltd. v. Rowe[45] is the governing authority. It upheld a "golden parachute" which provided for five years salary as severance pay if the executive were terminated following a change in corporate control. The court made an express finding that the directors had not acted in any way other than *bona fide*. Also, the court treated a "parachute-clause" as no different from any other term in a contract of employment; and thus, to be within the scope of directorial discretion.

3.2(h): Are Poison Pills Allowed in the U.K.?

As will be seen, *infra* in Chapters 4 and 5, American and Canadian companies derive the authority for a "poison pill" from the fact that their respective enabling statutes permit "rights" to be issued in respect to the purchase of shares.

Section 188 of the Companies Act, 1985[46] permits corporations in the U.K. to issue "warrants", but does not specifically mention the right of a British company to issue "rights" except in section 80(2)(b)[47] which states: "...any right to subscribe for, or to convert any security into, shares in the company...." A share warrant is defined by Black's Law Dictionary[48] as: "a certificate entitling the owner to buy a specified amount of stock at a specified time for a specified price...."

An analysis of the wording of the British act indicates that, on a plain reading of it, a share purchase rights plan would be authorized at law. However, due to the generally hostile attitude of the British courts in regards to the usage of hostile takeover defenses, it is an open question whether a British court would interpret "warrant" to include the "rights" issued under a "poison pill".

3.2(i): MLBO'S

As stated, while management-led leveraged buy-outs are not technically speaking takeover defenses, they are related. Unlike in the other two jurisdictions which are discussed *infra*, the Companies Act, 1985[49] prohibits a corporation from indirectly or directly assisting in the self-tender of its shares. This effectively debars a management team from entering the takeover fray as a rival bidder if they intend to structure the transaction as an LBO.

3.3: City Code on Take-Overs and Mergers, Rule 38[50]

Rule 38 prohibits any defensive action whatsoever by target management without the approval of the corporation's shareholders if the target company has reason to believe that a takeover may be imminent. It states:

> 38. During the course of an offer, or even before the date of the offer if the board of the offeree company has reason to believe that a *bona fide* offer might be imminent, the board must not, except in pursuance of a contract entered into earlier, without the approval of the shareholders in general meeting, issue any authorized but unissued shares, create or issue or permit the creation or issue of any securities carrying rights or conversion into or subscription for shares of the company, or sell, dispose of or acquire or agree to sell, dispose of or acquire assets of material amount or enter into contracts otherwise than in the ordinary course of business. Where it is felt that an obligation or other special circumstance exists, although a formal contract has not been entered into, the Panel must be consulted and its consent obtained.

Note that the City Code on Take-overs and Mergers is extra-judicial. Therefore, sanctions for breach are limited to public sanction, and/or prohibition of trading on the London Stock Exchange, and/or de-listing on the Exchange[51]. However, courts are influenced by the City Code when interpreting the propriety of directors' actions in contesting a hostile takeover[52]. This factor adds further uncertainty regarding how much British law has actually changed since the days of decisions such as Howard Smith Ltd. and Hogg v. Cramphorn.

3.3(a): Defensive Litigation

It must be noted that since regulation of mergers and takeovers is almost totally extra-judicial in the U.K., and since there is no legal standing for private citizens to engage in anti-trust related litigation, the opportunity for defensive-based litigation is virtually non-existent in comparison with Canada and the United States[53].

3.4: Conclusions Regarding the British Approach[54]

When analysing the British case-law, extra-judicial regulations, and statutory limits on the ability of target management to engage in hostile takeover defense mechanisms, it is obvious that a philosophical ideal regarding shareholders' "constitutional rights" is being placed at the forefront of the debate. It is also clear that the caselaw regarding the propriety of defensive actions has seen considerable flexing in recent years. However, at the same time, both the extra-judicial and statutory limitations on a target corporation's use of hostile takeover defenses have grown considerably.

Directors of British companies are truly in a double-bind. The City Code on Take-overs and Mergers, Rule 38, Hogg v. Cramphorn-type caselaw, as well as many sections of the Companies Act, 1985, severely limit, or even downright prohibit, any defensive action by target management when confronted with an unsolicited offer for a change in control of the corporation. At the same time, directors are clearly fiduciaries who owe an obligation to the company to act in its best interests.

The issue that virtually no British case, save the Cayne and Dawson decisions, has ever recognized or accepted, is that blocking a takeover may be in a company's best interests. Therefore, logic dictates, not only is the usage of defensive strategies not a breach of fiduciary duty in some circumstances; but rather, the non-usage of defensive strategies when confronted with an unsolicited offer to take control of a company which the directors view as detrimental to the company's interests, may be a breach of fiduciary duty.

Also note that the legal status of the defenses which have not been specifically dealt with, because there are no special rules relating to or affecting them in the U.K., is to be estimated by having regard to both the general rules dealing with the laws of fiduciaries, and the statutory rules dealing with corporate governance.

Chapter 4: The Canadian Approach

4.1: Introduction

The Canadian approach to this area of the law is not nearly as dogmatic or strict on management in comparison with the British position. The Canadian approach is, in general, an intermediate one between that of the "no defenses allowed" atmosphere which one finds in the United Kingdom on the one hand, and the "almost anything-goes" atmosphere which one finds in the U.S. state of Delaware.

4.2: The General Ability of Management to Act Defensively

4.2(a): The Law Pre-Teck Corp.

The first reported Canadian decision dealing with an allotment of shares which was designed to alter the balance of voting power among a company's shareholders is Martin v. Gibson et al.[55].

The facts are simple: the directors of a company issued themselves a block of shares to turn their position as minority shareholders into one in which the directors, together, controlled the majority of the shares in the company. The court followed the decision in Punt v. Symons[56] and set this share issuance aside as being improper, holding that it "amounted to a prejudicial encroachment on the voting power of the minority;..."[57].

When analysing this case one must remember that the directors were not trying to block a takeover which they believed to be detrimental to the company's best interests.

Rather, they were taking advantage of their positions as directors to se' :e control of the corporation.

In 1919, the Ontario Supreme Court handed down its decision in Bonisteel v. Collis Leather Co. Ltd.[58]. Its facts are somewhat similar to the forementioned Martin case. The distinguishing feature is that in this case, the court made an express finding of fact that the directors were acting in what they perceived to be the company's best interests. This is because the individual who owned controlling interest in the company was considered by the directors to be unfit.

Nevertheless, the court refused to distinguish the first case, treating itself as bound to follow it under *stare decisis*. The result being that the share issuance was set aside as a breach of fiduciary duty.

The next Canadian case dealing with a "one-sided share issuance" was the Spooner case[59]. A.G. Spooner, a director, entered into a self-dealing transaction with the company in which he advanced $20 000 cash and 240 acres of lands which were believed to be oil-bearing.

The Supreme Court of Alberta (Appellate Division) held that even if it could be proven that the director had entered into this contract with the sole motivation being to give an individual control of the company, this share issuance would not be set aside as a breach of fiduciary duty if the director honestly believed, on reasonable grounds, that this alteration of shareholder control was in the company' best interests.

4.2(b): *Teck Corp.*

In 1972, the Canadian position was somewhat clarified by the British Columbia Supreme Court's ruling in Teck Corp.[60].

Afton Mines owned some mineral claims near Kamloops, B.C., but did not have adequate funds with which to develop them. Therefore, Afton Mines Ltd. was looking for a larger mining company to take over the exploration and mining of this site in exchange for equity in Afton Mines Ltd. itself. Teck Corp. attempted to take over Afton Mines Ltd. via market accumulation as they wished to acquire these claims. By May of that year, Teck Corp. had already accumulated controlling interest in Afton Mines Ltd.. The board of directors of Afton Mines Ltd. opposed this change in control. This was because Teck Corp. had no experience in mining in the province of B.C.. As a defensive measure, the directors entered into a "white squire" agreement with Canex Ltd., a subsidiary of one of the world's largest mining companies.

The court refused to follow Hogg v. Cramphorn[61]; expressly disapproving of its reasoning. Instead, Mr. Justice Berger chose to follow the leading Delaware Chancery decision of the era - Cheff v. Mathes[62]. He held that there is a rebuttable presumption that: the directors's acts were the result of an honest belief, which is founded upon reasonable grounds, and was formed after a prudent investigation; and that there are no improper motives for the directors actions. This is the so-called "business judgment rule".

The learned justice also held that the directors were not only permitted to engage in defensive acts, but were actually required to do so, if they reasonably believed that the change in control would cause damage to the company. This is due to the fact that they are fiduciaries of the company, and correspondingly must act in its best interests. In the case at bar, the director, Mr. Millar, had acted reasonably in attempting to alter the bal nce of power in favour of Canex Ltd. because he reasonably believed that Canex Ltd. would do a better job of developing the mining sites.

The court also stated that directors were not restricted in only examining the effect that a change in control would have on the company and its shareholders. The directors are permitted to consider the effect it would have on the overall economy, the market, and the corporation's employees.

4.2(c): The Development of Canadian Law Since Teck Corp.

The decision in Teck Corp. has been upheld and applied in all but two of the reported and unreported decisions which have been decided since 1972 and deal with the issue of whether it is a breach of fiduciary duty for a company's directorship to engage in anti-takeover defenses[63]. The only appellate court in Canada to have dealt with this issue is the Manitoba Court of Appeal in the Olson[64] case; it having upheld the *ratio decidendi* in Teck Corp..

As stated, there are only two Canadian decisions that have ever refused to follow Teck Corp.. They are the Nova

Scotia Supreme Court decision in Exco Corporation v. Nova Scotia Savings and Loan Corporation[65], and the decision of Mr Justice Peter Cory of the Ontario High Court (as he was then), in the case of Bernard et al. v. Valentini et al.[66].

The court in the Exco Corp. case classifies much of what Teck Corp. is believed to stand for as being mere *obiter dicta*; thus limiting the decision in Teck Corp. to its facts. A fact pattern in which the primary purpose of the defensive actions was not to "frustrate" a bid; but rather, was an "intermediate" measure which was designed to secure the best possible deal for the corporation's shareholders (the best developer for a mining site). Note that this decision did not attempt to resurrect the old English doctrine that *mala fides* was automatically present anytime shares were issued for any reason other than to raise capital for the corporation. Instead, this case attempted to alter the burden of proof required of the directors to a higher standard, one that the directors were unable to meet in this particular case[67].

Bernard et al. v. Valentini et al. is a decision from the 1970's that attempted to resurrect the rule in Hogg v. Cramphorn as governing precedent in Canada. Note that not one other case since this decision, including Exco Corp., has accepted the old doctrinaire approach which held that "*mala fides* = share issuance for any reason other than raising capital".

In conclusion, it is clear that Teck Corp. is "the law" in Canada. And therefore, directors may, or may even be required to, engage in defensive actions during the course of a takeover battle.

4.2(d): Burden of Proof Required to Show Bad Faith

In an application for an injunction to restrain a share issuance during a takeover battle, Mr. Justice Peter Cory (then of the Ontario High Court) held in the 1978 decision of Bernard et al. v. Valentini et al. that injunctive relief did not require a strong *prima facie* case. But rather, merely required some "substantial issues" to be tried. This case can be considered to be an abberation as it conflicts with all of the other cases on point.

While there is some confusion about the exact level of proof required to show *mala fides* on the part of the directors during a share issuance[68], the general consensus is that, while the burden lies upon the complainant to prove a breach of fiduciary duty, the level of proof is one that demands more than a mere assertion of good faith on the part of the directors (i.e. some form of reverse onus). However, the level of proof demanded in the Exco Corporation v. Nova Scotia Savings and Loan case - that is, that the defensive tactics are totally inconsistent with any self-interest on the part of the directors - does not have support in any other Canadian decision.

4.2(e): Are Positive Steps Required to Fight A Takeover?

Section 122(a) of the Canada Business Corporations Act[69] (hereinafter referred to as the C.B.C.A.), and section 134(1)(a) of the Ontario Business Corporations Act (the O.B.C.A.)[70], both require that the "directors must act with a view to the best interests of the corporation".

The issue raised is this: Do these provisions create a positive duty on the part of directors to fight a takeover if they reasonably believe that it would not be in the best interests of the company to be taken-over by the putative acquiring entity? I believe that a plain reading of these sections makes it clear that the directors are under this positive duty. That is, it would be a breach of fiduciary duty to not engage in defensive tactics if the change in control is one that the directors perceive, or ought to perceive, as one that would have negative connotations for the corporation.

The Hiram Walker case[71] states that directors must "maximize shareholder value". This raises a second issue related to any possible positive duty to fight a takeover bid. That is, if the directors believe that a rival bid could be negotiated that would increase the return to shareholders, must they use every reasonable step to fight off the present one? It appears that this case stands for that proposition.

The ultimate test for a director would be the following scenario: An individual wants to acquire the company, and has made clear his or her intention to liquidate the company upon assuming control - s/he has offered $100 per share (Bid #1).

A second individual wishes to purchase the company for $95 per share; s/he has made it clear that s/he intends to "turn the company around" (Bid #2). Issue: The statutory requirements to "act with a view to the best interests of the corporation" seem to require that the directors use defensive actions to try to stop Bid #1, and allow Bid #2 to proceed. However, the Hiram Walker decision seems to require that the directors use all reasonable steps to frustrate Bid #2, as it is for a lower price. This issue is truly unresolved; leaving directors vulnerable to a breach of fiduciary suit no matter what their actions.

4.2(f): The Use of the Oppression Remedy Re Share Issues

It is clear that the oppression remedy could be invoked where a defensive action does not involve an actual breach of fiduciary duty, but still "unfairly disregards [the] interests [of the shareholder]"[72].

One issue that is unresolved is whether a shareholder can claim the oppression remedy based on the fact that his or her relative position as a shareholder has been reduced due to a share issuance whose primary purpose was to alter voting control among the shareholders[73].

Re Goldstream[74], a decision of the B.C. Supreme Court, holds that there is absolutely no right whatsoever for a shareholder to maintain his or her relative position in regards to the balance of shareholder voting power.

820099 Ontario Inc. v. Harold E. Ballard Ltd.[75] is an

Ontario Division Court decision which holds the opposite. That is, on the facts it was found to be oppressive for the director to issue shares to Harold E. Ballard, Sr. so as to permit him to solidify his already 99.9% stranglehold over the voting shares of the company. Note that there were very unique facts present in this case. This was not a situation in which the directors were defending against a takeover that they felt would be detrimental to the company's best interests. Rather, one particular director was attempting to placate the wishes of Mr. Ballard. That is, the director's actions were detrimental to the other shareholders, and the only motivation for this action was to prevent Mr. Ballard from voting that particular director out of office.

There are various ways to rectify these two cases. One is to limit the Harold E. Ballard Inc. case to its rather unique fact pattern. Secondly, one could classify Re Goldstream's insistence on there being no right whatsoever to maintain one's relative share position as mere *obiter dicta*. Of course, a judge could also just refuse to apply either decision as being wrongly decided, or as being extra-territorial.

However, the better view is that while there is no general right to have one's share position maintained, where the conduct is absolutely outrageous like in the Harold E. Ballard case, the oppression remedy would be available.

4.3: TSE By-Law 19.06 - A Toothless Remedy?

The TSE, Canada's premiere stock exchange, requires that all listed companies give immediate notice of any securities issues[76]. The potential penalties include de-listing of the corporation[77]. However, the TSE virtually never applies these sanctions as they harm the public even more than the offending company. Also, By-Law 19.06(2) permits the Exchange to require shareholder approval of this securities issuance if the issuance would materially alter control of the company.

In the matter of Re Torstar and Southam[78], the exchange was faced with two issues: Firstly, the issue of two companies who had wilfully and blatantly violated rule 19.06's requirement for notice. And secondly, the issue of requiring shareholder approval if the share issuance would have the affect of materially altering the control of the company.

There were rumours of a possible takeover bid for Southam Inc.. The Southam family, who controlled a large block of shares, attempted to have "shark repellents" placed in the company's articles of incorporation. Due to shareholder opposition to these proposed amendments to the corporate constitution, these were severely watered-down. The directors of Southam Inc. then issued a large block of shares to Torstar Inc., and the directors of Torstar Inc. did vice versa; these were accompanied with voting agreements. Thus, the two companies engaged in a "cross-ownership" share swap as a defense to a rumoured takeover bid for Southam Inc..

However, due to time constraints, neither company notified the Toronto Stock Exchange of these securities issuances. That is, they chose to blatantly violate By-Law 19.06. Secondly, shareholder approval was not obtained in regards to these share issuances that would not only materially alter control, but were expressly designed to do same.

The decision of the Ontario Securities Commission (O.S.C.) indicates how difficult "enforcement" of By-Law 19.06 will be. The O.S.C. stressed that it was improper to have so flagrantly disregarded By-Law 19.06. The commission emphasized that shareholder approval should have been obtained as this act limited the right of shareholders to decide whether to accept or reject a potential bid. However, the O.S.C. retroactively accepted notice of this share issuance so as to not inconvenience members of the general public. The only penalties which were imposed were temporary trade bans placed personally upon the directors who had engaged in this action.

4.4: Statutory Modifications to Defensive Abilities

4.4(a): The General Power To Manage A Corporation

In Canada, directors may sell assets of the corporation, announce dividends, and/or initiate a friendly merger under the "general power to manage" a company[79]. Of course, this is always subject to the directors acting *bona fide* under the general rules[80].

4.4(b): Transfer Restrictions

If a company is private, and has been incorporated under either the O.B.C.A.[81] or the C.B.C.A.[82], the directors have the power to refuse to register any share transfer if this is in the corporation's articles. Note that this section does not apply to publicly traded companies, except in situations where the transfer restriction is one which relates to a requirement for a certain percentage of the shareholders to be Canadian citizens.

4.4(c): Power to Purchase One's Own Shares

The Canada Business Corporations Act, does not generally permit companies which are incorporated under it to hold shares in themselves[83]. Nor are companies incorporated under the Ontario statute generally allowed to hold shares in themselves[84]. As well, neither statute permits these shares to be voted unless they are being held in trust for the company by a legal representative[85]. The C.B.C.A. does permit a corporation to purchase its own shares to reduce share capital[86]; as does the O.B.C.A.[87].

This removes a truly powerful weapon to defend against takeovers from the directors of companies (as the corporation's agents), as they would otherwise be able to consolidate the voting power of management during any proxy battles with a raider.

Also, another limitation on corporate self-tenders is that the Ontario Securities Act[88] prohibits selective self-tenders. This effectively prohibits the use of either "greenmail" payments or Unocal-type[89] self-tendering of shares under a back-end poison pill.

4.4(d): Power To Issue Shares

Section 25(1) of the C.B.C.A.[90], and Section 23 of the O.B.C.A.[91] permit companies incorporated under same to issue shares at any time, without shareholder authorization, a) if no limitations are contained in: a unanimous shareholders resolution, the corporation's by-laws or memorandum and articles; and b) the right of share pre-emption does not apply.

4.4(e): Staggered Boards Permitted & Removal of Directors

Companies incorporated under either the federal[92], or Ontario acts[93] may have staggered boards of directors, with terms of up to a maximum of three years[94] (i.e. one can "delay" a total turnover in the board by two years). However, this is not a strong "shark repellent" as directors can be removed by ordinary resolution under both statutes, regardless of anything to the contrary in the corporation's articles[95].

4.4(f): No Limitations Permitted Re Special Meetings

Another "shark repellent" which has been emaciated to be slightly less fierce than "Jaws" is the one that limits the ability of a shareholder to requisition a special meeting. The directors of companies incorporated under either the federal or Ontario acts must hold any requisitioned special meeting of the shareholders, except for several very limited exceptions[96].

4.4(g): Classes of Shares

"Unless the articles otherwise provide, each share of a corporation entitles the holder thereof to one vote at a meeting of shareholders"[97]. This clearly, by implication, permits shares to vary in the number of votes they may carry. Also, the two enabling statutes for corporations specifically allow a company to issue shares of more than one class[98].

One practical limitation on the use of this strategy is the TSE's rules regarding the listing of shares that have greater voting rights. TSE Notice to Members No. 89-322[99] requires that companies which desire to issue new shares to which are attached greater voting rights than any existing class of stock offer those shares on a proportionate basis to all existing stockholders (a right of pre-emption), and also that a majority of the minority shareholders approve of this distribution. Note that all other Canadian stock exchanges have identical rules[100].

4.4(h): Invalidity of Limitations Re Votes Per Shareholder

Sections 24(3) and 24(4) of the aforementioned C.B.C.A.[101] read as follows: "Where a corporation has only one class of shares, the rights of the holders... are equal in all respects...; The articles may provide for more than one class of shares and, if they so provide, (a)the rights, privileges, restrictions and conditions attaching to the shares of each class shall be set out herein..."

These two sections have been interpreted in accordance with "shark repellent" provisions that limited how many votes each shareholder was permitted at a meeting, regardless of how many shares those shareholders controlled. In both cases (the Bowater and Jacobsen decisions), the courts ruled these provisions of the articles to be *ultra vires* as they violated these sections[102]. That is, all the shares in each class must be treated the same no matter who controls them. The O.B.C.A. contains similar sections[103].

4.4(i): Special Majorities

Both the C.B.C.A.[104] and the O.B.C.A.[105], permit any clause in the corporation's articles, or any unanimous resolution of the shareholders, to require a higher than 50% vote of the directors or the shareholders to pursue any mentioned courses of conduct (i.e. a merger).

4.5: Poison Pills - Good Medicine for Canadian Shareholders, or a Bitter Pill to Swallow?

4.5(a): Introduction

"Poison pills" burst onto the Canadian landscape in 1988 when Inco Ltd. became the first Canadian corporation to adopt a share purchase rights plan[106].

There are only two judicial decisions which deal with the legality of "poison pills" in Canada. Both decisions analyze the issue from the perspective of whether it is a breach of fiduciary duty to enact such a plan, and whether the operation of the plan amounts to "oppressive" conduct.

4.5(b): The Common Law Re Validity of Poison Pills

The first case, the leading Canadian precedent on point, is _347883 Alberta Ltd._ v. _Producers Pipelines Ltd._[107]. Oppression and breach of fiduciary duty in both the enactment and continued usage of the pill were argued. It was also argued that "poison pills" are inherently invalid under Canadian law due to the "discrimination issue".

The facts are important, and are as follows: Saskoil's subsidiary 347883 Alberta Ltd. (347883) made clear that it intended to announce a formal takeover bid for Producers Pipelines Ltd. ("Producers") in the range of $16.00-18.00 Cdn. per share. The directors of Producers subsequently implemented a share purchase rights plan that contained a flip-in provision in which each rightholder got to purchase ten additional common shares per right at the price of $7.50 Cdn. per share. The "triggering event" in the rights agreement was a takeover bid by anyone who already owned at least 5% of Producers' common shares (that would include Saskoil's subsidiary - 347883). Of course, the rights would henceforth detach from all of the shares held by the entity who had triggered the "triggering event" in the agreement. It was never put to the shareholders for a vote.

The three major issues were: a)whether this kind of agreement was lawful, b)whether it was a breach of fiduciary duty for the directors to enact it, and c)whether this constituted "oppressive" conduct.

The chambers judge ruled that "poison pills" are lawful under s. 29(1) of the _Saskatchewan Business Corporations Act_

<u>(S.B.C.A.)</u>[108] which permits the directors of a company to issue "rights" to acquire securities in a corporation. Also, he held that shareholder approval is not required to implement a rights agreement; but, that it will be harder to prove *mala fides* on the part of the directors if one has been approved by a majority of disinterested shareholders.

And finally, perhaps most importantly, it was found that this defense is not void on the ground that it discriminates among shareholders - thus violating s. 24(3) and (4) of the <u>S.B.C.A.</u>[109] which is the Saskatchewan equivalent of the provisions which are discussed above in Chapter 4.4(h). The chambers judge reasoned that the "rights" alluded to in the forementioned statutory provision only relate to restrictions which are attached to the shares themselves. Therefore, they do not refer to any differential treatment of shareholders personally which is the result of the "poison" in this particular share option scheme.

The court further found that it was not a breach of fiduciary duty to enact this rights plan as its purpose was to delay a takeover bid, and thus allow the board of directors to undergo an evaluation of the company's market value to determine the "true" value of the shares. The evaluation came back at $19.00-21.50 Cdn. per share.

On appeal, the Saskatchewan Court of Appeal accepted by implication that "poison pills" are lawful, but did not actually make an express finding of same. However, the justices overturned the chambers judge on the grounds that, while the enaction of this "poison pill" was not oppressive, its continuation was.

Mr. Justice Sherstobitoff (writing for the majority) held that a "poison pill" will be valid if: a)the directors perceived, in good faith, a threat to the company and/or its shareholders; b)it was enacted after a proper investigation; and c)the defence is proportionate to the "danger" which is posed to the corporation and/or its shareholders.

The majority of the appellate panel accepted that it was acceptable to enact the "poison pill" in the first place. However, the court found the means to be disproportionate (and thus oppressive) based on the following grounds. 1)It was unreasonable, even though the law does not require it, for the plan to not have been put to the shareholders for ratification. 2)The Court of Appeal notes that the oppressive takeover techniques known as "street swaps" (buying blocks of shares from institutional investors and arbitrageurs at a premium, then paying other shareholders a lower price), "greenmail", and "two-tier front-loaded takeovers" are rare or non-existent in Canada due to the different regulatory environment. 3)Also, the Court of Appeal looks to <u>National Policy 38</u>[110], which limits the usage of takeover defenses, as an interpretive guide. 4)And finally, the majority judgment brings up the issue of "shareholders' democratic rights"; rights that are found to have been violated.

In summary, the majority found that the continued enactment of this "poison pill" was totally out of proportion to the "threat" faced by the company; thus constituting oppressive conduct on the part of the directors in regards to the shareholders.

McGill Law School's Robert Yalden[111] has criticized the Court of Appeal's decision in the forementioned case on the following ground: what he considers to be the inappropriate use of National Policy 38 as an interpretive guide in regards to common law fiduciary duties. His main argument is that judges should not be using vague policy statements from un-elected political appointees who sit on securities commissions as a guide to the interpretation of statutory rules.

In the unreported decision of the Alberta Court of Queen's Bench, Remington Energy Ltd. v. Joss Energy Ltd.[112], Fraser, J. upholds the Saskatchewan Court of Appeal's decision in 347883 Alta. Ltd. v. Producers Pipelines Inc.; finding the "poison pill" in question to be a disproportionate response to the perceived threat due to the fact that shareholder approval, while not legally required, should have been sought.

4.5(c): The Ontario Securities Commission's Approach

The Ontario Securities Commission has on several occasions dealt with the issue of share purchase rights plans; in the first two, ruling it was "time for the pill to go".

Re Canadian Jorex Ltd.[113] is the first decision; dating from 1992. The O.S.C. saw the issue very clearly as being:

"...whether it was in the public interest to put an end to the rights plan so that the shareholders could decide whether they preferred the bid of M. Ltd. or CT Corp., if any."[114].

The Securities Commission decided that it was in the public interest for the "poison pill" to cease medicating the shareholders. Their decision is based upon the following grounds: 1)One of the bids was going to be withdrawn if the pill was not ended; thus denying the shareholders the right to decide whether or not to accept the bid. 2)The pill had delayed the first bid; resulting in an "auction" in which a second bidder had joined the fray, and there was no realistic chance of a third bidder coming into existence. 3)There was no evidence that the first bid (the Mannville bid) was going to be enhanced if the pill remained in place. Underlying this decision were two other issues: the O.S.C. looking to National Policy 38 as an interpretive guide, and the fact that the shareholders had not ratified the scheme.

The second decision of the O.S.C. was in the case of Lac Minerals Ltd. and Royal Oak Mines Inc.[115]. In this case, the pill was ruled to have outlived its usefulness, even though the shareholders had approved it, as: 1)The approval was three years old, and the shareholders could not have foreseen the exact state of affairs that were present at that time. 2)There was no real possibility of another bidder joining the fray. 3)If it were not ended, one or both of the bidders may withdraw their bids which would deny the shareholders the right to decide whether to accept either bid, if any.

MDC Corp. and Regal Hastings & Gifts Inc.[116] was decided shortly after the Lac Minerals case. Applying the same test as in Lac the commission found that the operation of the "poison pill" to still be in the public interest due to two distinguishing factors: the overwhelming majority of the shareholders supported its continued existance, and it had not yet stimulated a share auction so its continued existance would likely enhance shareholder value.

Note that the TSE has in the past refused to register the "rights" under a "poison pill" under its authority conferred under By-Law 19.06, unless a majority of the corporation's shareholders have voted in favour of the scheme[117].

4.5(d): Back-End Rights Plans

The provisions of the Ontario Securities Act[118] effectively nullify any back-ends rights plans of companies either incorporated in Ontario or listed on the Toronto Stock Exchange. This is because it prohibits selective issuer bids for shares.

4.5(e): Conclusions Regarding Poison Pills

While the legality of "poison pills" in Canada is not 100% ironclad (due to the claim that they are "discriminatory", and thus illegal under the O.B.C.A.'s s. 22 and the C.B.C.A.'s s. 24), the better view is that they are not *void ab initio* on the grounds that they discriminate among shareholders[119]. However, they must be proportionate to the threat faced by the company, and they must have not "outlived their usefulness" to be permitted to continue to operate[120].

4.6: National Policy 38[121]

The policy is partially based on the British City Code on Take-Overs and Mergers, Rule 38[122], and is fully discussed by Beck & Wildeboer[123]. " National Policies" issued by the securities commissions do not have the force of law[124]; being merely interpretive guides for all securities regulators in Canada. The policy states:

> 1. The Canadian securities administrators recognize that take-over bids play an important role in the economy by acting as a discipline on corporate management and as a means of reallocating economic resources to their best uses. In considering the merits of the take-over bid, there is a possibility that the interests of the target company will differ from those of its shareholders. Management may take one or more of the following actions in response to a bid that it opposes:
>
> (i) attempt to persuade the shareholders to reject the offer;
>
> (ii) take action to maximize the return to shareholders, including soliciting a higher offer from a third party; or
>
> (iii) take other defensive measures to defeat the bid.
>
> 2. The primary objective of take-over bid legislation is the protection of the *bona fide* interests of the shareholders of the target company. A secondary objective is to provide a regulatory framework within which the take-over bids may proceed in an open and even-handed environment. The rules should favour neither the offeror nor the management of the target company, but should leave the shareholders of the offeree company free to make a fully informed decision. The administrators are concerned that certain defensive measures taken by management may have the effect of denying to shareholders the ability to make a decision and of frustrating an open take-over process.

3. The administrators have determined that it is inappropriate...to specify a code of conduct for directors of a target company, in addition to the fiduciary standard required by corporate law. ...However, the administrators wish to advise participants in the capital markets that they are prepared to examine the target company tactics in specific cases to determine whether they are abusive of shareholder rights. Prior shareholder approval [of defensive measures] would, in appropriate cases, allay such concerns.

4. Without limiting the foregoing, defensive tactics that may come under scrutiny if undertaken during the course of a [takeover] bid, or immediately prior to a bid if the board of directors has reason to believe that an offer might be imminent, include:

(i) the issuance, or the granting of an option on, or the purchase of, securities representing a significant percentage of the outstanding securities of the target company;

(ii) the sale or acquisition, or granting of an option on, or agreeing to sell or acquire, assets of a material amount; and

(iii) entering into a contract other than in the normal course of business or taking corporate action other than in the normal course of business.

5. The administrators consider that unrestricted auctions produce the most desirable results in take-over bids and is reluctant to intervene in contested bids. However, the administrators will take appropriate action where they become aware of defensive tactics that will likely result in shareholders being deprived of the ability to respond to a take-over bid or to a competing bid.

6. The administrators appreciate that defensive tactics,..., may be taken by a board...in genuine search of a better offer. It is only those tactics that are likely to deny or severely limit the ability of shareholders to respond to a take-over bid or a competing bid, that may result in action by the administrators.

7. As a general rule, the administrators or their staffs will not advise parties as to the propriety of proposed action in a particular case except in the

> context of a meeting or proceeding or which interested parties have been given notice.

As seen in the previous sub-chapter, it is clear that the securities administrators will step in and halt a share issuance, or put an end to a "poison pill", or otherwise re, :ain a defensive act if they feel that the forementioned policy is being violated.

4.7: Conclusions Regarding the Canadian Approach

While there is some level of uncertainty in the Canadian law, directors in Canada are in a much clearer position than are directors of British companies. One thing that is clear is that Canadian directors must inform the shareholders of all defensive acts being undertaken during the course of a contested takeover bid or they may be liable under the oppression remedy[125].

Chapter 5: Delaware: Does Anything Go?

5.1: The Development of the Business Judgment Rule

5.1(a): Introduction

When one examines the American approach to this area of the law of corporations one finds two important differences in comparison with both the Canadian and British regimes regarding the ability of target management to engage in defensive manoeuvres. The first is that the present status of the law is much clearer in Delaware in comparison with Canada and especially the U.K.. Secondly, target management are given much more leeway in dealing with takeovers in comparison with the other two jurisdictions.

5.1(b): The Law Pre-Unocal

Any meaningful discussion of Delaware law must begin in 1964 with the seminal decision of the Delaware Supreme Court in Cheff v. Mathes[126]. It carried on, and refined, the tradition of many previous Delaware authorities[127].

Cheff's facts are as follows: The directors purchased a dissident stockholder's shares at a substantial premium over market value after he attempted to attain a seat on the corporation's board during a proxy battle and criticized certain facets of the present directors' management of the company. The directors were sued in a derivative action for breach of fiduciary duty.

The court found for the directors. The justices based their decision on the "business judgment rule". That is, there was a rebuttable presumption of law that the directors, if the directors were independent and disinterested, had acted reasonably and honestly and in good faith and with no improper motivations, and only after undertaking a prudent investigation. The court was only prepared to interfere with this exercise of "business judgment" if there were no reasonable explanations offered for this action (or deliberate choice to refrain from a course of action) by the directors, and/or there was evidence of conflict of interest, and/or the totality of the circumstances indicate the presence of *mala fides*.

On the facts, the directors were able to show reasonable grounds for the belief that the continued existence of this shareholder constituted "a danger to corporate policy".

This case literally opened the floodgates for directors to use defensive tactics in a hostile takeover situation. However, one must remember that the floodgates were not totally wide-open. This is because the directors were not entitled to use these defenses merely as a means to keep their jobs. Rather, they were required to show that they had reasonable grounds to believe that the employment of a particular defense was necessary for the benefit of the company. Therefore, it was to be a question of fact in each particular case whether the directors had abused their authority, or had properly exercised it to the company's benefit.

Note that this case proved to be especially influential, and was not only the reigning precedent in Delaware up until 1984[128], but was also the basis for the forementioned seminal Canadian precedent of Teck Corp.[129].

5.1(c): Unocal and Heightened Judicial Scrutiny of Defenses

The mid-1980's saw the Delaware courts clarify, and significantly modify, the rule governing the ability of target management to engage in defensive actions. It is no longer one of "anything and everything goes" under the test of the presently reigning precedent of Unocal Corp. v. Mesa Petroleum Co.[130].

Unocal's facts are somewhat unique in that the target management was not only attempting to defend the company from a hostile takeover, but was also attempting to protect the shareholders from being steam-rolled by an unethical and abusive takeover practice which was being used by Texas Oilman T. Boone Pickens' Mesa Petroleum Co.. In the judgment, the court calls T. Boone Pickens a "greenmailer", and describes his actions as a "coercive" and "abusive" front-loaded, two-tier, junk-bond-financed takeover.

Mesa Co. had made a tender for Unocal Corporation. The consideration for the first 37% of tendered shares (Mesa Petroleum Co. already owned 13%) was something of actual value - money. The second 49% of shareholders who did not initially tender were to be "squeezed-out" in a second stage going private transaction. The "consideration" was to be high-risk "junk bonds" purportedly "worth" $54.00 U.S. per share.

The nature of this transaction was obviously coercive as individuals may well tender their shares to prevent ending up (if enough other individuals tendered) with their shares in a world-leading petroleum company literally being turned into "junk". This transaction was also blatantly unfair as the individuals who were being shown the corporate door at stage two of the bid would receive worthless "junk" as supposed "consideration" for their shares. Note that the suit was commenced by the raider, and not by another shareholder in a derivative action claiming that their "right to sell" had been interfered with.

The company responded to this hostile bid by adopting a self-tender plan for their own shares (a "back-end poison pill"). Any individual who did not tender their shares to Mesa Petroleum Co. was to receive over $70 worth of Unocal Corp. debentures for each share they tendered to the company. The exception was that Mesa Petroleum Co. was specifically excluded from this self-tender.

This action's effects were as follows: a)it removed any coercion from the tender offer as shareholders no longer had to fear being "stuck" with "junk bonds" if they did not tender; b)it guaranteed that the shareholders received consideration equal to the true long-term value of the company; c)if effected, it would saddle Unocal Corp. with six billion dollars U.S. in debt, thus making it a much less valuable (virtually worthless?) company.

The court held that the board was justified in undertaking this course of action based on the "modified" business judgment rule. Directors did not have the authority to use "Draconian" measures. Nor could directors act out of a desire to stay directors.

Due to the risk that directors were acting out of self-interest, and also the risk that directors could engage in overkill and harm the corporation through overly-aggressive defensive measures; the court ruled that the directors could still enjoy the benefit of the business judgment rule in the context of a takeover battle, but that the protection of the rule would be severely reduced. Therefore, in the takeover context it would be a weaker presumption of sound business judgment which would be treated with significantly heightened judicial scrutiny.

The court adopted a "threshold inquiry" in which the following factors were examined to determine whether the board's actions were reasonable in relation to the threat posed to the corporation and its shareholders by T. Boone Pickens' tender offer. The board was allowed to consider the following factors (among others) when deciding whether to engage in defense(s), and when deciding which defense(s) to employ: the adequacy of the consideration for the shares, the nature of the offer (i.e. coercive two-tier bid versus an any-and-all shares bid), whether the bid involved illegality (i.e.

anti-trust issues, violation of takeover laws, etc.), and the takeover's potential effect on the corporation's employees and on society at large.

This case, like the forementioned Teck Corp. decision from British Columbia, creates a reverse onus on the part of target management to provide some evidence that their actions are not self-motivated, or to at least provide some explanation for their utilization of anti-takeover defenses.

On the facts, the court found that the actions of the board: were reasonable in relation to the threat posed, were entered into after a reasonable investigation, and were not motivated in any way by a desire to "keep their jobs". Thus, the defensive actions were entitled to the protection of the "modified business judgment rule".

5.1(d): Unocal Corp. Since Unocal Corp.

When one examines the treatment by the Delaware courts of subsequent cases dealing with management's choice to utilize hostile takeover defenses, it becomes clear that while the courts have followed and upheld the *ratio decidendi* in Unocal Corp., they have applied it in a more strict manner. This has further restricted the ability of target management to employ same[3].

The general trends that one teases out of the subsequent case-authorities regarding when a defense will be ruled to be a breach of fiduciary duty, or when it will be permitted under the modified version of the business judgment rule, are as follows:

<u>a)Likely to be Struck Down</u>:

- The defense was entered into during an active takeover battle, and it appears that management's decision to employ takeover tactics was undertaken hastily and without due deliberation[132].

- The adoption of the defense has the effect of terminating an active bidding contest[133].

- It appears that the directors may have been motivated out of self-interest (i.e. the desire to remain directors)[134].

- Fundamental principles of the shareholders' right to choose are being severely limited[135].

- The directors appear to reject any bid, no matter what the amount, no matter who it is from, and there does not appear to be any long term strategic reason for this action (the so-called "Just say no!" strategy, or "Nancy Reagen Defense")[136].

- The directors are not attempting to block a takeover, but are actually attempting to undo an already completed one[137].

- Members of management are part of a rival bidding group attempting a management-led takeover, especially where this is concealed from the shareholders[138].

- The defense appears to be excessive and totally out of proportion to the threat faced (i.e. the "cure" is worse than the "disease")[139].

- Management appears to be favouring certain bidders during a <u>Revlon</u>-style auction[140].

- The defensive strategy entrenches management and appears to be self-serving. In the <u>Robert M. Bass Group Inc.</u> v. <u>Evans</u>[141] case, the Delaware Court of Chancery had little trouble finding a recapitalization program which increased management's control of voting shares from 4.5% to 39%, while providing the shareholders with an inferior economic return in comparison with the tender offer, to be a breach of fiduciary duty.

b) When Defenses Are Likely to Be Upheld:

- The defense is not designed to block a bid, only to make a two-tier bid non-coercive, or to guarantee that the consideration which the shareholders receive is reasonable like in Unocal itself.

- The board consulted outside experts whose independence is unquestionable[142].

- The bidder is using abusive tactics, or has a reputation as a "black knight" or "corporate raider" or "greenmailer" or "takeover artist", like in Unocal itself where the judge calls T. Boone Pickens a "greenmailer".

- The consideration offered for the shares appears inadequate[143].

- Any defense utilized appear to be the "least harmful" like in the Moran decision[144].

- A majority of the directors are so-called "independent" or "outside" directors[145].

5.1(e): Unocal and Parachutes

Three cases heard in non-Delaware courts[146] in which Delaware law was applied (i.e. the courts attempted to estimate what the decision of a Delaware court would be based on the business judgment rule), laid-down some clear guidelines governing when "parachutes" will be struck down as either a breach of fiduciary duty, a waste of corporate assets, or for being void as against public policy.

If there are outside directors who approved of a "parachute" clause, and they themselves are not to gain anything from these terms, it is likely that the courts will treat this as a valid exercise of managerial discretion. If it was entered into well in advance of any takeover and was part of an overall compensation package, it will likely be upheld. However, outrageously generous compensation packages that "inside" directors grant themselves in their capacity as corporate officers during a takeover battle will likely be ruled unenforceable.

It must be kept in mind that it is very rare, if ever, that a Delaware court will even permit an individual to attack any "parachutes". That is because Delaware courts interpret standing rules very strictly to automatically debar from launching an action any individual who is no longer a shareholder - no longer a shareholder as they were bought out during the takeover itself[147].

5.1(f): Unocal and Greenmail

Delaware courts have treated "greenmail" no differently from any other defense, having upheld it under the Unocal Corp. test in Polk v. Good[148]. This is in contrast to the jurisdiction of California. There, it was held by the Court of Appeal in the Disney[149] case that a preliminary injunction could be granted to hold the "greenmail funds" in trust while a shareholders' derivative action against the directorship for breach of fiduciary duty wound its way through the courts. The theoretical basis of the Court of Appeal's decision was apparently that this payment may not only be a breach of fiduciary duty on the part of the directors, but also on the part of the "greenmailer" as an aider and abettor of a tortious act.

A new punitive tax of 50% on any "greenmail profits" will likely dramatically reduce its usage in the United States[150]. Also, as will be seen in Chapter 5.2(b), *infra*, the discriminatory self-tendering of shares has been severely limited since 1986 due to new SEC rules.

5.1(g): Unocal & Poison Pills: The Moran Decision

Moran v. Household International Inc.[151] followed the same year as Unocal Corp.. It dealt with the ability of a corporation to adopt a share rights purchase plan as a general defensive action to deter any putative future takeover attempts.

This "poison pill" was challenged by a dissident shareholder on three grounds: the issuance of these "rights" was not authorized under Delaware corporate law, this deprived shareholders of their "right" to receive a takeover offer, and that it unduly limited an individual's practical ability to engage in a proxy battle.

The court ruled that these were permitted under section 157 of the Delaware General Corporation Law[152]. Furthermore, the court held that "poison pills" adopted as a general defense were entitled to the protection of the modified business judgment rule. The court found this enacting of the pill to be a reasonable exercise of business judgment by the board of directors.

The idea that this would prevent the waging of a proxy battle was rejected, as an individual could still acquire the rights to vote another shareholder's stocks through a voting agreement, and was therefore still able to wage an effective proxy battle.

Also rejected was the notion that this would prevent tender offers. The court noted that it merely restricted the practical ability to launch a hostile bid; but did not debar all takeovers.

Revlon[153] also dealt with the adoption of a "poison pill" by target management. However, in this case it was adopted as a specific defense to a bust-up raid that was to be financed by "junk bonds".

The court accepted that this was a reasonable action to take; affording the directorship the protection of the modified version of the business judgment rule. However, the maintaining of the scheme was ruled to be a breach of fiduciary duty under the same standard, as it was maintained after the two bidders made higher offers that exceeded the price that the board had set as their minimum - serving no valid purpose whatsoever by this point in time.

More recent decisions, some of which are unreported, are discussed by Laura Cox[154]. The general rules regarding when a "poison pill" will be permitted are as follows: if it is being used to delay a bid and stimulate an auction, or if it is being used as a general deterrence to any possible future takeovers, or it is being used to defend the shareholders against a tender offer which is based on inadequate consideration; it is likely that the court will show great deference to the directorship's decision to implement the pill.

In one leading case a five prong inquiry was employed to decide whether the decision to implement, or retain, a "poison pill" was a reasonable one[155]. The five stages of inquiry were as follows: Firstly, whether the board had reasonable grounds to believe that the enaction of the plan, or its non-redemption, was necessary as a matter of corporate policy. Secondly, the court examined whether the directors actions were *bona fide*, or whether there was the presence of *mala fides*. A third factor examined was whether the board had undertaken a proper investigation. Fourthly, the court examined the independence of the board of directors (i.e. the portion who were "outside" directors). A fifth factor was the proportionality test. That is, the court asked whether the enactment of a pill, and/or its continuation, was reasonable in comparison with the threat faced.

Presumably, the fact that there was shareholder approval of a share purchase rights plan would aid the directors at the proportionality step of the inquiry.

5.1(h): The Disruption of Proxy Battles & Unocal duties

Two pre-Unocal decisions make it clear that management may not use their power to attempt to thwart shareholder opposition. Note that both of these decisions, as pre-1985 decisions, are still good law as the standard at that time was more management-friendly. That is, if these actions were breaches of fiduciary duty in 1967 and 1980, they would certainly be considered breaches today under the heightened judicial scrutiny that commenced in 1985 with the seminal decision of the Supreme Court of Delaware in Unocal Corp.. In the case of Condec Corp. v. Lunkenheimer Co.[156], the directors advanced the date of an annual meeting with the sole purpose being to disrupt a proxy battle. The ability to alter the date of an annual meeting was a power conferred upon the directors in the corporation's by-laws. However, the court had little difficulty finding a breach of fiduciary duty to have occurred. The court remarked that it is a long-held aspect of Delaware law that managers may utilize corporate assets to advance management's opinions during a proxy battle. However, the court finds that this action was designed to thwart any-and-all shareholder opposition so that the present management could entrench themselves.

Thirteen years later, in 1980, the Delaware Court of Chancery decided the case of Lerman v. Diagnostic Data[157]. It involved the directorship of a company racing around trying to amend the corporation's by-laws with the sole purpose being the disruption of a proxy contest led by a dissident shareholder. Here, the decision was the same. The court found that the only two purposes of this act were to derail any-and-all criticism of management policy, and to entrench the present management.

It must be remembered that the Delaware courts have not totally debarred any-and-all manipulation of proxies by management as a defensive measure. Under the heightened judicial scrutiny of the "modified business judgment rule", a company was permitted to delay a shareholders' meeting which had not yet been called to give management time to organize a response, and to prevent it from coinciding with a hostile tender offer[158].

5.1(h): Modified Business Judgment & Revlon-Auctions

In 1986, the Delaware Supreme Court enunciated the duties of target management when there is contested bidding for the company among several parties. Revlon held that when a company is in "auction-mode", the only consideration of the directors is to achieve the highest price for the shareholders. That is, when it becomes clear to the directorship of the target company that there is no realistic chance of the company pursuing long-term strategies, and/or that the company's break-up and/or sale is inevitable, and/or the company has been "put up for sale" by the present directorship, the company has entered "Revlon-mode". At that point, the duty of the directors is to disregard all interests save the maximization of shareholder financial interests - maximization via the securing of the best tender offer possible.

The basic rationale is as follows: once the corporation's directors have determined that the company should be "put up for sale", or it realistically becomes inevitable that the company is going to be sold, there is no possible way a change in control could harm current corporate effectiveness. Thus, the directors must accept the bid which is "best" for the shareholders, and are debarred from favouring certain bidders over others. Thus, once Revlon-mode is triggered, the only defensive strategies that are permitted are ones which are designed to maximize shareholder value (i.e. a "poison pill" used to delay one tender offer while a higher-priced bid is seeked out). Defensive strategies which are designed to "defend the company", or to ensure that one bidder wins out because management believes it to be a better "suitor" for the company, are absolutely prohibited.

However, the importance of this rule is somewhat questionable. This is due to the fact that subsequent decisions of the Delaware courts have failed to find "Revlon-mode" triggered in many cases that appear, at first blush, to be factually similar to the Revlon decision.

Newmont Mining[159] held that a change in ownership of one shareholder's stock from 26% to 49.7%, with the congruence of management, through an open-market accumulation, was not a change-in-control transaction that would trigger Revlon duties on the part of the directors. Presumably, the result would have been different if the individual's share portion had increased to 50%+1, so as to give him not only *de facto* control, but also *de jure* control.

The Supreme Court of Delaware held in Bershad v. Curtiss-

Wright Corp.[160] that the rule in Revlon was not triggered where a corporation effected a cash-out merger with a subsidiary as corporate control was not being changed, but merely strengthened on the part of the person who already had control.

The Time[161] case held that a friendly merger agreement entered into by the management of Time Inc. was not the corporate equivalent of a "for sale" sign as this constituted a true merger of the corporations; thus "corporate control" was not for sale. The court also accepted that this merger was a strategy which was designed to maximize shareholder value over the long-term, and that Time Inc.'s sale was not inevitable. Therefore, Revlon-type duties on the part of the directorship did not come into play.

The Interco Inc.[162] case held that a fundamental restructuring of a company was not akin to a sale; and therefore, that the rule in Revlon is not triggered.

Mills Acquisition Corp v. Macmillan Inc.[163] further limited the scope of Revlon. It held that the directors were under a duty to get the best overall bid - not the highest priced bid. Therefore, management was entitled to look at factors other than the price (i.e. method of payment, timing of payment, etc.). And, was thus permitted to favour certain bidders over others if the directors reasonably believed that this would result in the consummation of the best possible deal for the shareholders. However, the directors were under a reverse onus to prove that their discriminatory actions in relation to certain bids were designed to maximize shareholder value.

Paramount Communications v. QVC Network[104] is the latest pronouncement of the Delaware courts regarding when the rule in Revlon will be triggered. Paramount Communications was attempting to reposition itself in the global market by merging with another titan of the communications industry. Paramount's board initiated a friendly merger in which it was to be purchased by Viacom. The two corporations entered into a friendly merger agreement which contained a "no-shop clause", and both liquidated damages of $100 million and a lock-up to purchase 19.9% of Paramount's outstanding common stock if a rival bidder won out. Since "corporate control" was for sale at the initiation of Paramount's board (unlike Time, which the court distinguishes, this agreement did not involve a "true consolidation"; but rather, a purchase of one company by another, on-duties were triggered. While the court does not criticize the inclusion of these three clauses in the original agreement (presumably these could be justified as necessary to get Viacom to agree to the merger), they find a breach of fiduciary duty to have taken place when the balance of power shifted to Paramount and it was clear that Paramount's directors could have insisted upon the amending of the merger agreement to have these clauses eliminated.

In conclusion, it is clear that the directors of a company which is "on the auction block" have heightened, and different, duties under Revlon's interpretation of Unocal Corp.. However, the Delaware courts have drastically limited the scope of when the courts will determine that there is a "for sale" sign on the corporate lawn; and therefore, that these different duties have actually been triggered.

5.2: Statutory Provisions Affecting Defensive Actions

5.2(a): Staggered Boards and Removal of Directors

Section 141(d) of the Delaware General Corporation Law permits corporations which have been incorporated under it to have "staggered boards of directors". This must be adopted in a shareholders' by-law, or in the corporation's certificate of incorporation. The corporation is permitted to have "different classes" of directors whose terms of up to three years may expire at different times. Also, any directors who are serving staggered terms of directorship may only be removed "for cause"[165].

5.2(b): Self-tendering of Shares

Section 160[166] of the same act basically gives Delaware corporations a "free-reign" in purchasing, and holding, and voting, any shares which have been issued by the corporation. However, the Securities and Exchange Commission's rules were revised in 1986[167] to prohibit the discriminatory self-tendering of shares; effectively debarring any company which is listed on any American stock exchange from either paying "greenmail", or engaging in a Unocal-style self-tendering of shares under a "back-end poison pill".

Note that Delaware, unlike some other states such as New York, does not have any statutory provisions which either directly regulate, or downright prohibit, the payment of "greenmail"[168].

5.2(c): *Special Meetings - Must they be Called if Requisitioned?*

In Delaware, special meetings of the shareholders can not be called by the shareholders unless this right is specifically conferred in the corporation's certificate of incorporation[169]. Otherwise, the only procedure for the holding of a special meeting is if the directors requisition one themselves.

5.2(d): *Separate Classes of Shares & Transfer Restrictions*

Section 202[170] of Delaware's forementioned corporate enabling statute permits a corporation to issue shares which contain transfer restrictions. Section 212(a) of same[171] permits a corporation to issue shares which vary in the number of votes each carry. As well, section 151 of the act[172] permits Delaware corporations to issue more than one class of share, as long as that power is conferred by the corporation's certificate[173].

However, a practical impediment to the usage of "separate classes" of shares and/or transfer restrictions as a general defense to any potential hostile takeovers is that the NYSE refuses to list shares in a company which has any shares of this sort[174].

5.2(e): Special Majorities to Amend the Shark Repellent Provisions &/OR Approve any Proposed Merger

Delaware's Code permits any corporation to include in its certificate a provision requiring greater than 50% approval of the shareholders for any course of action[175].

5.2(f): The General Power to Manage the Corporation

A general power to manage the corporation is conferred upon the directors of a Delaware company[176]. As well, the directors are granted the express power to initiate any sale, lease, or exchange of any corporate assets[177]. A further power which is granted to the directors of a Delaware corporation is the power to issue stock at anytime if the "stated capital" in the certificate is not yet "full"[178].

Note that these powers are always subject to the limits placed upon them by the law of fiduciaries which is discussed above.

5.2(g): Maximum Votes Per Shareholder

In the case of Providence and Worcester Co. v. Baker[179], the Delaware courts were faced with the virtually identical fact pattern as were the Canadian courts in the Bowater[180] case. The Delaware courts struck down a provision in a corporation's certificate which limited the number of votes which could be voted by a single shareholder. It was held to violate section 151(a) of the Delaware General Corporation Law.

5.2(h): *The Williams Act & State Anti-takeover Legislation: The Opportunity to Engage in Defensive Litigation*

"Tender offers" are regulated by the Williams Act[181]. There is some confusion in the caselaw regarding whether a target corporation is even able get an injunction to stop a takeover based on allegations of alleged violations of same[182]. Another factor limiting the ability of American target companies to engage in defensive litigation based on alleged violations of same is the fact that courts in the United States have severely limited what is considered to be a "tender offer" for the purposes of the act[183]. Only a formal tender offer submitted to the corporation's management is considered to be a "tender offer". Any other takeover tactic, such as through market accumulation, is considered to not be a "tender offer" for the purposes of the act.

Section 203 of the Delaware General Corporation Law is a so-called "second-generation state anti-takeover statute". While the constitutionality of state anti-takeover legislation used to be in doubt, three federal district court decisions have upheld this provision; declaring that it is not *ultra vires*, nor is it pre-empted by federal legislation[184].

Note however, that American companies do have standing to engage in anti-trust related litigation[185].

5.3: Conclusions

The American position is one which grants target management a relatively "free hand" regarding the usage of hostile takeover defenses. As will be seen in the following chapter, the reasons for this are not only due to a different philosophical tilt of the American courts. Rather, there are fundamental differences in regards to the overall takeover regimes of these three countries which affects the amount of discretion which the legislatures, regulatory bodies, and the courts are willing to give target management.

Chapter Six: Reasons for the Law's Variation in its Treatment of Hostile Takeover Defenses: The Overall Takeover Environments & Takeover Regimes

6.1: Introduction

Before any meaningful comparison of the three forementioned jurisdictions can be embarked upon, the entire takeover "picture" must be examined. This is to prevent the temptation to examine only one aspect of a jurisdiction's legal regime, and then to make recommendations without looking at other factors which may have affected a court or legislature's adoption of that particular rule. As will be seen, the differences that exist between the three jurisdictions are not only philosophical, but are also the result of structural factors.

6.2: The Canadian Environment and Legal Regime

6.2(a): The Canadian Takeover Environment

Traditionally, Canada has had very little over-the-counter trading in comparison with the United States[186]. Therefore, issuers of stock in Canadian public companies have been limited in the realistic alternatives to listing their shares on a registered exchange such as the TSE; thus having to abide by any of the exchange by-laws which regulate any aspects of takeovers.

Corporate ownership in Canada is extremely tightly controlled - much more so than in the United States. It is so concentrated that approximately 80% of the Canadian companies which make up the TSE 300 Composite Index were effectively or legally controlled by one of nine prominent Canadian families during the early 1980's[187]. There has been little change in the concentration of Canadian corporate wealth in the past decade - in the early 1990's over fifty percent of major Canadian corporations were still legally or effectively controlled by one shareholder[188].

Canadian takeover activity, measured as a percentage of GNP to adjust for the differential size of the U.S. economy, was proportionally two-and-one-half times as large as in the United States during the period from 1980-85[189] - the height of "merger mania". Canada set an all-time record in 1995 with the aggregate value of all mergers and acquisitions (including foreign acquisitions by Canadian companies) coming in at an astonishing Cdn. $77 billion[190].

6.2(b): Canadian Takeover Regulation

The fundamental difference between Canadian and American takeover regulation is the scope of the protection provided to shareholders during a takeover. In Canada, takeover bids are regulated by corporations law, securities law, and stock exchange regulatory bodies (i.e. the TSE by-laws).

As will be seen, "street swaps" and front-loaded two-tier bids are, for all practical purposes, illegal in Canada.

C.B.C.A. s. 194 defines a "takeover bid" very broadly. It is defined as any offer to acquire shares that, if combined with any shares already owned, would exceed ten percent of any class of issued shares in the company. The O.B.C.A. s. 187.1

defines "takeover bids" virtually identically. The Ontario Securities Act[191] also includes this definition, but its provisions are only triggered at 20% ownership. Due to constitutional reasons, it only applies to persons, individuals or corporations, which are "situated" in Ontario[192]. The TSE by-laws also include a similar definition of "takeover bid"[193].

The O.B.C.A.[194] and the C.B.C.A.[195] both exempt offers made to fifteen or fewer shareholders. However, "sweeping the street" to accomplish a takeover by buying blocks of shares from institutional investors and arbitrageurs is effectively prohibited. This is because the TSE by-laws[196], and provisions of the O.S.A.[197], both define takeover bids in such a way as to include private purchases of more than five percent of the shares in any class during the previous year.

All three forementioned statutes, and the TSE's by-laws, then proceed to give shareholders similar protection to that provided by the American Williams Act which is discussed *infra*[198]. However, enhanced protection is provided which effectively debars any takeover artist in Canada from utilizing the abusive and coercive two-tier takeover tactic. That is because, the "going private" phase of a two-step transaction is regulated in Canada so as to ensure that any appropriation of the stockholdings of minority shareholders is for fair value[199].

As was mentioned in Chapter 4.4(c), and in the Lac

Minerals Ltd.[200] decision of the O.S.C., "greenmail" is, for all practical purposes, illegal in Canada.

However, it must be remembered that the protection of the TSE By-Laws is somewhat questionable as is seen above in Chapter 4.3(a) where By-Law 19.06 and the Re Torstar and Southam case are both discussed.

It is clear that the Canadian legal environment protects Canadian shareholders and corporations from the two coercive and abusive American tactics of "greenmail" and two-tier bids, and also from the discriminatory practice known as "street swaps". As well, since the definition of "takeover bid" is so much broader in comparison with the scope of the Williams Act[201] "tender offer", the statutory protections for shareholders are triggered much more frequently in Canada than in the U.S.

6.3: The British Takeover Situation and its Regulation

6.3(a): The U.K.'s Takeover Environment

The ownership of shares in the United Kingdom is more concentrated than in the U.S.A., but less so than in Canada[202].

Like Canada and the United States, there were literally thousands of takeovers which were announced for companies listed on London's Exchange during the 1980's[203]. In 1988, and again in 1989, the aggregate value of British hostile takeovers surpassed the U.S. $20 billion mark; however, the market has cooled somewhat in the 1990's[204].

Over-the-counter trading of stocks is very limited in the United Kingdom, to the point of near non-existance[205]. Thus, companies which are publicly traded must be listed on the London Stock Exchange; and therefore, subject to its regulation.

6.3(b): British Regulation of Takeovers

The regulation of takeovers is under the City Code; the sanctions for which are wholly extra-judicial[206], and include de-listing of the stock off of the London Stock Exchange. There is no statutory regulation of takeovers in the United Kingdom.

The City Code is similar to the American Williams Act which is discussed in the following chapter. However, there is important additional protection which the City Code provides to shareholders of a target company.

Firstly, the coercive effect of a two-tier bid is not possible in the U.K., as rule 9[207] of the City Code requires any person who, along with agents, acquires thirty percent or more of a company's stock to offer to buy out all of the other shareholders at the highest price which the acquirer paid for the shares in the previous twelve month period.

Secondly, partial bids are severely regulated to the point of almost prohibition. For any takeover that would see the acquirer achieve control of over 30% of the company's stock, but is an offer for less than 100% of the shares; the Panel must give its approval, and it will only advance this approval if a majority of the company's shareholders (excluding shares voted by the acquirer) approve this "partial bid"[208].

Also, this same rule effectively eliminates the potential for a raider to discriminatorily "sweep the street" so as to buy large blocks of shares at a "control premium" from institutional investors and arbitrageurs.

It must be pointed out that there are both disadvantages, as well as advantages, in regards to this extra judicial regulation of hostile takeovers. The obvious advantage is that the Panel is not overly legalistic; thus, there is little "manoeuvring around the act" via legal loopholes[209]. However, since it is extra-judicial, its enforcement[210], like the enforcement of the TSE By-Laws[211], is questionable. Obviously, this would be especially true in regards to individuals who are not part of "The City's" corporate culture, and are therefore not deterred by any potential trading bans (the most severe penalty that can be imposed).

6.4: The American Takeover Environment & Its Regulation

6.4(a): Merger Mania Hits America

Even the most casual reader of the American popular press during the 1980's would have heard about "takeover mania"[212]. "Hostile takeovers", "corporate raiders", "arbitrageurs", "institutional investors", "ELBO's", "MLBO's", "poison pills", "target management", "white squires", "junk bonds", the investment banking firm of Drexel Burnham Lambert, and "tender offer" all became household words.

During the go-go mid-1980's the value of the largest hostile takeovers was literally in the billions of dollars per deal[213].

While American corporate control is concentrated, it is not nearly as concentrated as it is in Canada - i.e. there are not 81 families (9 families X 9 times the population) who effectively or legally control eighty percent of the Dow Jones Industrial Average companies. Institutional investors, such as brokerage houses, banks, trust companies, pension funds, mutual funds, and insurance companies controlled over half of the shares of major American public companies during 1992[214], and about 50% of the shares of the fifty largest American corporations during the late 1980's[215].

The percentage of stocks that are publicly traded, and yet are unregulated by exchange rules, is quite large in the U.S.A.. This is because of the very active over-the-counter-market for shares which exists in the U.S.A.. The NASDAQ, the leading American over-the-counter market, handles virtually the identical share volume of the world's leading stock exchange - the NYSE[216].

One thing that is important to understand is that during the 1980's many of the hostile takeovers were highly leveraged ones in which high-risk, high-yield securities ("junk bonds") were used to finance the deals. However, the "junk market" has severely retracted in the 1990's - to the point of almost collapse[217]. The obvious implication is that defensive strategies which rely on the raising of the interest rate on any "junk bonds" issued to finance the takeover will not be as effective as before - back when "junk was king".

6.4(b): American Federal "Non-Regulation" of Takeovers

As will be seen, the regulation of hostile takeovers in the United States and in the state of Delaware is almost non existent in comparison with Canada and the United Kingdom. The American takeover environment is unfettered capitalism at its best - or its worst - depending on one's political leanings and love of the corporate equivalent of total chaos.

As stated, the regulation of takeovers is accomplished through the 1968 Williams Act, which is within U.S. federal jurisdiction under the power to regulate interstate commerce[218].

This act does the following:

- It requires full disclosure of any and all terms of a bid[219].
- It also permits shareholders to withdraw their already-tendered shares within seven days of a bid having been sent to him or her[220].
- Requires a *pro rata* taking up of shares in the situation in which a bid is over prescribed[221].
- Mandates that any increased consideration which is offered for shares during the course of a bid be shared by all shareholders, even those who have already tendered at the lower price[222].
- Prohibits the usage of "...fraudulent, deceptive, or manipulative acts or practices in connection with any tender offer or

request to invitation for tenders..."[223].

- Requires that bids be kept open for twenty business days after they have been announced[224].

At first blush, it appears that the American shareholder is quite well protected from any perceived abuses that could take place in the context of a takeover. However, the American courts would see fit to rectify that "problem".

Firstly, the prohibition on the usage of "fraudulent or deceptive practices" has been severely limited by the United States Supreme Court to basically only refer to deception under the disclosure requirement[225].

Secondly, what exactly is a "tender offer"? The courts in the U.S.[226] have held that the following are not "tender offers" for the purposes of the act: "street swaps"; any transaction involving "sophisticated parties", as these individuals do not "need" the act's protection; and, stock accumulation through an exchange.

The result is clear: American shareholders have an act that protects them if it applies, which is only where: "there will be a substantial risk that solicitees will lack information needed to make a careful appraisal of the proposal put before them."[227]; or, offers would have "the overall effect of pressuring shareholders [excluding the pressures of the marketplace] into selling their stock...."[228].

6.4(c): Delaware Fills the Void?

To fill in the void created by the American courts, the state of Delaware created a "second generation" takeover code - section 203 of the Delaware General Corporation Law[229]. As mentioned above, its constitutionality is not in issue[230]. And, nor is it pre-empted by the Williams Act[231].

The act does not provide for any Williams Act style protections. Rather, it prohibits any "business combination" with an "interested stockholder" that has not been either: a)approved, in advance, by the corporation's board of directors; or, b)the transaction leading to the individual becoming an "interested stockholder" resulted in their accumulation of 85% of the voting stock of the corporation which was outstanding at the time the transaction commenced, excluding shares owned by corporate directors, or officers, or employee stock plans in which the employees do not have the right to confidentially determine whether to tender shares in a putative tender offer; or, c)the "business combination" is subsequently approved by the board of directors, and is subsequently approved by a vote of two thirds of all outstanding voting shares at an annual, or special, meeting, excluding any shares owned by the "interested shareholder"[232]. "Business combinations" and "interested shareholders" are defined quite broadly, so as to include virtually any takeover and/or merger[233].

It must be noted that this statute then sets out a lengthy list of exceptions[234], which even include the opting-out of its provisions either by an amendment to the corporation's certificate, or the inclusion of such an opt-out provision in the original certificate of incorporation.

In summary, it becomes clear that this provision's "protections" are rather modest at best. In reality, is all that this provision is, is a statutory form of "shark repellent". That is, this section is not an act which "gets to the root of the problem" by protecting the shareholders from abusive takeover tactics (i.e. banning "greenmail", two-tier bids, and "sweeping" Wall Street's arbitrageurs and institutional investors). Rather, it creates a statutory form of hostile takeover defense mechanism.

6.4(d): Fiduciary Duties in a Freeze-Out

American minority shareholders are not totally unprotected during the second stage of a two-tier bid as Section 262 of the Delaware General Corporation Law[235] requires that "fair value" based upon "all relevant factors" be advanced to any shareholders being "squeezed-out" in a two-step merger. As well, there is a fiduciary duty owed by the controlling shareholder to act fairly in regards to the minority shareholders during the going-private stage of the transaction[236]. This is in direct contrast to the United Kingdom and Canada where there is no generally recognized fiduciary obligation which a controlling shareholder is viewed as owing to the other shareholders[237].

6.5: Discussion

Now that the entire "picture" has been examined, it is clear why the rules relating to the utilization of takeover defenses are so much more liberal in the United States in comparison with the other two jurisdictions. In one sentence: Canadian and British shareholders do not need protection from abusive takeover tactics in the same way that American shareholders do.

Not only that, but there is also deep philosophical differences in the three jurisdictions regarding what exactly a corporation is. For example, in the U.K. corporations are seen almost as forms of limited partnerships in which the directors are agents of the shareholders[238]. Unlike the O.B.C.A.[239], C.B.C.A.[240], and Delaware General Corporation Law[241], there is no provision in the Companies Act, 1985[242] which gives the directors a general power to manage the corporation. The only powers a British director has are ones which are derived from the corporate constitution — a sort of "contract" between the directors and the shareholders. British law even recognizes a "residual power" in which the shareholders may manage the company if the directors are unable or unwilling to do same[243].

While in the U.S., corporations are seen as distinct entities, separate from the shareholders; entities which are managed by professionals who owe their primary allegiance to the company, and where any fiduciary duty owed to the shareholders is secondary[244]. The Canadian cases[245] take a philosophical middle ground between these positions.

Chapter Seven: In Light of: the Anecdotal Evidence Regarding the Costs of Defenses, Empirical Data Regarding the Effect on Share Prices of Takeover Defenses, Scientific Data in Regards to Mergers in General, and the Theoretical and Philosophical Issues; What Can the U.S.A. & the U.K. "Teach Canada" About this Area of the Law?

7.1: Takeover Defenses - Costly & Harmful to Share Prices

A review of the cases and of the scientific data makes it clear that the utilization of takeover defenses by target management negatively affects the price of that company's shares. Also, the employment of defenses are often very expensive in and of themselves.

7.1(a): Some Anecdotes

The following list is some of the "prices" to the defending company of utilizing takeover defenses.

- Unocal Corp.'s self-tender plan (if it had gone through), which was used to defend itself from Mesa Petroleum's hostile bid, would have saddled the corporation with six billion dollars worth of debt[246].

- There are reports of corporations using "suicide tactics" and "scorched earth" tactics, such as going into liquidation, just to escape the clutches of a hostile bidder[247].

- Virtually every usage of defenses by target management results in years of litigation for the company as dissident shareholders commence derivative actions left, right, and centre.

- The utilization of the Pac-Man defense can lead to a "Mexican Standoff" in which both corporations are totally paralysed[248].

- "Golden Parachute" payments are getting truly out of control. For example, in 1983 William Agee, Bendix Corp.'s chairman, got over four million dollars U.S.[249]. That amounts to starvation-pay by the standards of today's "platinum parachutes"; after being fired as chair of Warner

Music, Robert Morgado is reported to have received sixty million dollars U.S. as severance[250].

- In the case of Edelman v. Fruehauf Corp.[251] the corporation's directorship was attempting to vest nearly $100 million of over-funding in the employees' pension scheme.

- Some of the payments of "greenmail" which were made during the 1980's in the U.S.A. are as follows[252]:

  - Saul Steinberg being paid $60 000 000 over market value for his stockholdings by the Walt Disney Corporation.

  - Texaco purchasing the Robert M. Bass Group's shares for $1.2 billion.

  - Ronald Perelman getting Gillette to pay him $43 million over the previous day's closing price for his shares.

  - The Belzberg clan selling their shareholdings in USG to USG for $37 million "extra".

  - The Phillips Petroleum Co.'s self-tender of Mesa Petroleum Co.'s shares in Phillips for millions over the exchange price.

It must be emphasized that, due to the necessity of brevity in this thesis, this list of costly defensive measures is far from exhaustive. What is clear is that defenses are often costly and can even be destructive, as in the case of companies whose desire to stay independent leads to the corporate equivalent of suicide.

7.1(b): Defenses Do Harm Share Values

There are empirical studies which examine whether "shark-proof" corporate constitutions and "poison pills" are beneficial or harmful to the price of shares in the companies with same. The evidence is clear that share prices are adversely affected by the utilization of general deterrents to takeovers[253]. For example, the article cites empirical data which indicates that "super-majority provisions" and "poison pills" are both associated with a three percent decline in the value of the corporation's common shares.

7.1(c): Mergers Result in Gains to Target Shareholders

There has been an enormous scientific, political, and economic debate surrounding whether mergers are efficient or not. The twists and turns of this debate are beyond the scope of this thesis, and are unnecessary for my analysis as there are certain areas of common ground on all sides of the debate; the area upon which most everyone agrees is the one which is relevant to my discussion.

It is beyond refute that takeovers grant the shareholders of target companies massive returns on their stock - in the early-to-mid 1980's it was an average of 30%[254].

As well, no one disputes the basic argument of Easterbrook & Fischel[255] that takeovers are good discipline for the management of target companies - even Martin Lipton, the "leader" of the anti-takeover, pro-management school of opinion accepts that this is true[256]. If takeovers function as good discipline for the management of companies (which is generally accepted), then any limitation on them (i.e. through the usage of defenses) will "reduce" the strength of this discipline. Logic tells us that takeover defenses thus have a fourth adverse affect on the returns of shareholders on top of 1)reducing share prices, 2)denying shareholders any premium in a takeover bid, and 3)the costs of the defense itself; 4)that is, by weakening a "stick" (a hostile takeover) that is being held over the heads of managers everywhere. That is, by removing the threat of a hostile takeover, managers may "entrench" themselves and continue to mismanage a company with very little risk of being "thrown out"; some commentators[35] argue that such "management entrenchment" is the primary reason for the utilization of anti-takeover devices by target management.

7.2: Democracy Itself - Is It At Risk?

It is clear that the usage of takeover defenses infringes on the ability of shareholders to sell their shares to a raider - that is their primary purpose. This clearly violates the principle of shareholders' democracy - i.e. a shareholder should be able to sell his/her shares to someone else if s/he so desires. Individuals' rights to sell or buy goods (after all, shares are a "good") should not be interfered with lightly in a free and democratic society.

For example, I cite data in the previous sub-chapter which indicates that target shareholders receive a significant premium for their shares when they tender them. People may say: "What if the offer is 'inadequate'?". So what! If management thinks that a hostile bidder's offer is for less than the "true long-term value of the company", should they really be permitted to tell banks, pension funds, and individual investors (who are presumably adults) that they may not sell their shares as the offer is not "enough"?

7.3: Are Mergers Good for the Economy as a Whole?

The scientific data and economic models are literally "all over the map" regarding whether mergers are "good for everyone" and not just for target shareholders.

Studies reviewed by Professors Jarrell, Brickley, & Netter[258], as well as normative models from law and economics[259] claim that the bidder's shareholders, and society as a whole, gain from a takeover due to the fact that assets have been transferred to a more efficient usage and the fact that "corporate synergies" have been created.

Others, such as Professor Coffee[260], and Professor Scherer[261] are more sceptical. For example, Professor Scherer notes that there is often a drop in the value of the bidding firm after a takeover. As well, Professor Scherer points out that notorious insider trader Ivan Boesky made a fortune by short-selling stock in the raider; presumably the reason for this adverse market reaction to the stock of the company launching the takeover bid was an assumption that the takeover was a wealth transfer from the bidder to the target by a firm which had grossly overpaid[262].

While the general trend of the data indicates that hostile takeovers have value-maximizing effects[263], the results are still quite equivocal. Therefore, the notion that takeovers should be limited or banned altogether is unpersuasive as the marketplace should not be interfered with on the basis of such contradictory findings; especially if, as is the case, a slight preponderance of the research indicates that takeovers do in fact have wealth-enhancing effects.

7.4: Where Do We Go From Here?

As stated above in paragraph 6.4(b), there is virtually no scope for the utilization of abusive[264] and coercive tactics in Canada. At the same time, there is clear evidence that target shareholders benefit from takeovers. As well, there is insufficient evidence of takeovers having an adverse effect on the overall economy to warrant any position other than neutrality.

On the basis of the forementioned factual and theoretical and philosophical background it would appear that I am going to recommend a total ban on defensive tactics. That is not the case as any absolute rule ends up being inflexible, doctrinaire, and over-inclusive. It is clear that the utilization of hostile takeover defenses are associated with economic harms to the target's shareholders, as well as constituting interference in the marketplace. However, in Canada there will always be scope for the usage of takeover defenses in the two circumstances where the maximization of shareholder value requires it: a search for a rival bid which is higher[265], and cases in which there are special facts present in which the company's effectiveness and continued prosperity require one bidder to be favoured over another, such as in the case of Teck Corp.[266].

In light of this, I propose that the higher evidentiary burden in Exco Corp.[267] be adopted in lieu of the more relaxed rule from Teck Corp.. That is, the utilization of defenses would not be totally banned, but could only be used in circumstances in which the usage of the defenses were inconsistent with any motivation other than the best interests of the shareholders. This would still permit takeover defenses to be used where the situation is clear that the interests of the shareholders require it. At the same time, the negative effects of takeover defenses could generally be avoided as the scope for their utilization would be narrowly circumscribed. For example, on the facts of Teck Corp. itself, defenses would have been permitted to be used as the action was inconsistent with anything other than the best interests of the shareholders.

In addition, whether or not the shareholders had approved of, or opposed, a defensive action should always be a relevant evidentiary factor[268]. There are two reasons for this: Firstly, the negative price declines which are associated with the utilization of general defenses are not as strong when the defenses are ones which have been approved by the shareholders[269]. Secondly, there is the flipside of the philosophical issue of "shareholders' rights": that is, the shareholders should have a collective right to decide that they want the directorship of the company to utilize defensive tactics, and thus to have their "rights to sell" be interfered with.

In general though, Canada's approach has avoided the doctrinaire ideology and judicial inflexibility which has pervaded the British approach to this area of the law, leaving British directors in a true double-bind. As well, it has avoided the main problem which plagues the British City Code[270] - its questionable value as a deterrent. This is because Canadian extra-judicial enforcement of takeover defenses is ancillary to, and in addition to, the statutory and judicial regulation.

At the other extreme, Canada has avoided Delaware's "anything goes" atmosphere which has had some pretty extreme results. An environment in which directors may engage in incredibly drastic action which both severely limits the rights of shareholders to determine whether to sell their shares, and can end up being astonishingly expensive and harmful to the company. Why is this situation allowed to continue in the U.S.A.? Because securities and corporate statutes in the United States have yet to be reformed to protect shareholders from abusive takeover practices; thus, American courts have allowed directors "to fill the void".

Any regulation of this area of the law is fraught with difficulties due to the conflicting demands from various constituencies. That is, the requirement that a balance be struck between the interests of shareholders, and the traditional corporate law objective that a company's directorship be given flexibility to manage the company in what they perceive to be its best interests. One can only hope that the Canadian regime continues to stick to its "middle course" that has avoided the pitfalls of both the American and British regimes.

Endnotes

1.F. Iacobucci, "Planning and Implementing Defences to Take-Over Bids: The Directors' Role" (1981), 5 C.B.L.J., 131, at 133.

2.M. Lipton, "Takeover Bids in the Target's Boardroom: A Response to Professors Easterbrook and Fischel" (1980), 55 N.Y.U.L. Rev., 1231.

3.F. Easterbrook & D. Fischel, "The Proper Role of a Target's Management in Responding to a Tender Offer" (1982), 94 Harv. L. Rev., 1161. Note that the authors advance a fourth argument: that of "the problem of sunk costs" - I deal with this argument in endnote 265 which accompanies chapter seven.

4.Technically, the usage of the term "undervalued" is inaccurate as the two authors argue that it is impossible, almost by definition, for shares to be "undervalued". This is because they accept the normative model from economics which holds that in an efficient capital market all goods (shares are "a good") will be appropriately priced by rational wealth-maximizing individuals; thus, the shares can not be "undervalued". When I use the term "undervalued" I am referring to shares which are trading at a market price which is less than the firm's break-up value. The distinction is really one of semantics - I use "undervalued" to mean "less than the break-up value" - Easterbrook & Fischel use "value" to mean "what someone is willing to pay for it", and therefore nothing can be "undervalued" as that would be less than someone is willing to pay for it, which is conceptually impossible.

5.(1963), [1967] Ch. 254, [1966] 3 All E.R. 420, 3 W.L.R. 995, 9 Digest (Cont. Vol. B) 98 para. 1903a (Ch. Div.).

6.D. DeMott, "Comparative Dimensions of Takeover Regulation" (1987), 65 Wash. Univ. L.Q., 69.

7.*Ibid*.

8.The TSE's share of the Canadian listed equity market is currently 80.7% based on the aggregate value of the securities. See: The TSE Review (Feb. 1996, 6).

9.*Supra* 6.

10.*Supra* 1; *supra* 6. B.C. and N.S. companies do vary somewhat in that they are "memorandum of association companies".

11. *Supra* 6.

12. *Supra* 6.

13. Am. Jur., vol. 19, 2nd ed., para 2592, notes that many American corporations are re-incorporating in the state of Delaware due to its relatively lax regulation of corporations.; *infra* note #15 Takeover Defense, vol. 1, 4th ed., at 133 & 155.

14. 1980 Sec. Ann. Rep., vol. 128.

15. For a general discussion of the following takeover defenses see: Am. Jur., vol. 19, 2nd ed., para. 2515-2607 (Rochester: Lawyers Cooperative, 1994); *supra* 1; M. Lipton et al., "Mergers and Acquisitions: Developments in Takeover Techniques and Defence" (memorandum of law distributed by the New York City law firm of Wachtel, Lipton, Rosen & Katz, Nov. 18, 1988), in J. Ziegel et al., Cases and Materials on Partnerships and Business Corporations, vol. 1, 2nd ed., (Toronto: Carswell, 1989) 597; L. Reiser, "Corporate Takeovers - A Glossary of Terms & Tactics" (1984), 89 Case & Comment No.6, 35; R. Phalon, The Takeover Barons of Wall Street: Inside the Billion Dollar Merger Game (New York: Putnam, 1981); A. Fleischer et al., Takeover Defense, vol. 1, 4th ed., (Engelwood Cliffs, NJ: Prentice Hall, 1990); R. Ferrara, M. Brown, & J. Hall, Takeovers, Attack and Survival: A Strategist's Manual, (Clearwater, Fla.: Butterworths, 1987).

16. Poison Pills are described in the following articles: P. Dey & R. Yalden, "Keeping the Playing Field Level: Poison Pills and Director's Fiduciary Duties in Canadian Take-Over Law" (1990), 17 Can. Bus. L.J., 252; J. Forsyth, "Poison Pills: Developing a Canadian Regulatory and Judicial Response" (1989), Dal. L.J., 159; G. Coleman, "Poison Pills in Canada" (1989), 15 Can. Bus. L.J., 1; L. Cox, "Poison Pills: Recent Developments in Delaware Law" (1989), 58 U. Cincinnati L.R., 611.

17. (1903) 89 L.T. 525, 2 Ch. 506, 72 L.J. Ch. 768, 52 W.R. 41, 47 Sol. Jo. 619, 10 Mans. 415, 9 Digest (Repl.) 302 para. 1900 (Ch. Div.).

18. (1919), [1920] 1 Ch. 77, 89 L.J. 509, 122 L.T. 20, 35 T.L.R. 703, 64 Sol. Jo. 35 (Ch. Div.).

19. Rights and Issues Investment Trust Ltd. v. Stylo Shoes Ltd. et al. (1964), 3 All E.R. 628 (Ch. Div.).

20.*Supra* 5.

21.(1969), 1 All E.R. (C.A.).

22.<u>Howard Smith Ltd.</u> v. <u>Ampol Petroleum Ltd.</u> (1974), 1 All E.R. 1126, A.C. 821 (P.C.).

23.<u>Teck Corp. Ltd.</u> v. <u>Millar</u> (1972), 33 D.L.R. (3d) 288, [1973] 2 W.W.R. 385 (B.C.S.C.).

24.<u>Heron International Ltd. et al.</u> v. <u>Lord Grade, Associated Communications Corp. PLC et al.</u> (1982), [1983] B.C.L.C. 244 (C.A.).

25.(1986), B.C.L.C. 382 (Ch. Div.).

26.(Aug. 12, 1982) (Ch. Div.) [unreported], aff'd on other grounds, (1982), [1984] 1 All E.R. (C.A.).

27.(1988), 4 B.C.C. 305 (Scottish Ct. of Session, Outer House).

28.<u>Companies Act, 1985</u> (U.K.), S.I.F., 1991, c.6.

29.<u>Council Directive 77/187 on the approximation of the laws of the Member States relating to the safe guarding of employees' rights in the event of transfers of undertakings, businesses or parts of businesses</u>, OJ L61/77.

30.*Ibid.* s. 368.

31.*Ibid.* s. 162.

32.*Ibid.* s. 143(2)(b).

33.*Ibid.* s. 169.

34.*Ibid.* s. 142.

35.*Ibid.*

36.See Chapter 5.1(c), *infra*.

37.*Supra* 28 s. 125-129 permits the variation of class rights - by implication this permits shares to vary in the rights attached to various classes of shares.

38.<u>The Stock Exchange, Admission of Securities to Listing</u>.

39.*Supra* 28 s. 80.

40.*Supra* 28 s. 9.

41.*Supra* 28 s. 378.

42.*Supra* 28.

43.*Supra* 28 s. 312-316.

44.*Supra* 28.

45.(1977), 3 All E.R. 123, [1978] A.C. 537 (P.C.)

46.*Supra* 28.

47.*Supra* 28.

48.5th ed. (St. Paul, Minn.: West, 1979).

49.*Supra* 28 s. 151.

50.Panel on Take-Overs and Mergers, City Code on Take-Overs and Mergers, Rule 38.

51.Halsbury's Laws of England, 4th ed. (London: Butterworths, 1988) para. 1040.

52.See *supra* 25.

53.D. DeMott, "Current Issues in Tender Offer Regulation: Lessons from the British" (1983), 58 N.Y.U.L. Rev., 945, at 1017.

54.Note that under a proposed EU Commission Directive, a rule based upon the British rules which limit the utilization of anti-takeover strategies by target management would become applicable in all of the EU Member States. See: "EU Proposes Takeover Rules to Protect Shareholder Rights", The Globe and Mail (Feb. 8, 1996, B9).

55.(1907), [1908] 15 O.L.R. 623 (Ont. S.C.).

56.*Supra* 17.

57.*Supra* 55 at 623 (headnote).

58.(1919), 45 O.L.R. 195 (Ont. S.C.).

59.Spooner v. Spooner Oils Ltd. et al. (1936), 2 D.L.R. 634 (Alta. S.C.).

60.*Supra* 23.

61. *Supra* 5 - the leading British authority of the era.

62. *Infra* 126.

63. Northern & Central Gas Corp. Ltd. v. Hillcrest Collieries Ltd. et al. (1975), [1976] 1 W.W.R. 481 (Alta. S.C.); Shield Development Co. Ltd. v. Snyder et al. and Western Mines Ltd. (1975), [1976] 3 W.W.R. 44 (B.C.S.C.); Re Royal Trustco, (July 9, 1981) (Ont. H.C.) [unreported]; First City Financial Corp. Ltd. v. Genstar Corp. et al. (1981), 3 O.R. (2d) 631 (Ont. H.C.); Olson v. Phoenix Industrial Supply Ltd. et al. (1984), 9 D.L.R. (4th) 451, 4 W.W.R. 254 (Man. C.A.); Dixon v. Merland Explorations Ltd. and Turbo Resources Ltd. (1984), 30 A.L.R. (2d) 310 (Alta. S.C.); Re Olympia and York Enterprises Ltd. and Hiram Walker Resources Ltd. (1986), 59 O.R. (2d) 254 (Ont. H.C.); Re Goldstream Resources Ltd. (1986), 2 B.C.L.R. (2d) 244 (B.C.S.C., in chambers); 820099 Ontario Inc. v. Harold E. Ballard Ltd. (1991), 3 B.L.R. 113 (Ont. Ct. (Gen. Div.)); Starcom International Optics Corp. v. MacDonald, (March 11, 1994), (B.C.S.C.) [unreported].

64. *Ibid*.

65. (1987), 35 B.L.R. 135 (N.S.S.C.).

66. (1978), 18 O.R. (2d) 656, 83 D.L.R. (3d) 44 (Ont. H.C.).

67. See Chapter 4.2(d), *infra*.

68. See for example the various comments made by judges in the cases cited *supra* 63.

69. R.S.C., 1985, c-44; Note that under Canadian rules of federalism, the C.B.C.A. only applies to acts incorporated under it - s. 3 of same.

70. R.S.O., 1990, B. 16; This act applies only to corporations which are incorporated in the province of Ontario - s. 2.

71. *Supra* 63.

72. 347883 Alberta Ltd. v. Producers Pipelines Ltd. (1991), 4 W.W.R. 151 (Alta. C.A.); *supra* 63 820099 Ontario Inc. v. Harold E. Ballard.

73. *supra* 70 O.B.C.A., s. 248; *supra* 69 C.B.C.A., s.241: these are the two relevant statutory provisions relating to the "oppression" remedy for companies incorporated under the either the Ontario or federal

statutes.

74. See *supra* 63 Re Goldstream.

75. *Supra* 63.

76. Toronto Stock Exchange, General By-Laws, s. 19.06.

77. *Supra* 15 J. Ziegel et al.. at 661.

78. (1986), 9 O.S.C.B. 3088 (O.S.C.).

79. *Supra* 77, at 620; *supra* 69 C.B.C.A. s. 102(1); *supra* 70 O.B.C.A. s. 115.

80. See Chapter 4.2, *supra*.

81. *Supra* 70 s. 5(1)(d) & s. 42(1)(d).

82. *Supra* 69 s. 6(1)(d) & s. 174(1)(a).

83. *Supra* 69 s. 30 - Note the limited exceptions in s. 30(2) to 36.

84. *Supra* 70 s. 30.

85. *Supra* 70 O.B.C.A. s. 29(8); *supra* 69 C.B.C.A. s. 33.

86. s. 34(1) of C.B.C.A., *supra* 69.

87. s. 30 of O.B.C.A., *supra* 70.

88. R.S.O., 1990, ch. S 5, s. 89(1).

89. *Infra* Chapter 5.1(c).

90. *Supra* 69.

91. *Supra* 70.

92. *Supra* 69 s. 106(4).

93. *Supra* 70 s. 118(5).

94. *Supra* 69 s. 106(3); *supra* 70 s. 119(4).

95. *Supra* 69 s. 109(1); *supra* 70 s. 122(1) - Note that section 1 of both acts defines an ordinary resolution as being 50%+1 of the votes of the class(es) of shares entitled to vote.

96. *Supra* 69 s. 143(1); *supra* 70 s. 106(3); The major exceptions include: the meeting being requisitioned deals with a matter that primarily addresses a personal grievance or a matter that was voted on and defeated within the past two years, an annual meeting has already been called and the shareholders have been sent notice of this, and/or the matter is an abuse of process which is designed to seek publicity.

97. *Supra* 69 s. 140(1); *supra* 70 s. 102(1).

98. *Supra* 69 C.B.C.A. s 24(4); *supra* 70 O.B.C.A. s. 22(4).

99. (Nov. 9, 1989), supplementing TSE Policy Statement on Restricted Shares.

100. *Infra* 106 footnote #33, p. 262.

101. *Supra* 69.

102. Jacobsen v. United Canso Oil & Gas Ltd. (1980), 113 D.L.R. (3d) 427 (Alta. Q.B.); Bowater Canadian Ltd. v. R. L. Crain Inc. (1987), 62 O.R. (2d) 752 (C.A.).

103. *Supra* 70 s. 22(3) & s. 22(6).

104. *Supra* 69 s. 6(3).

105. *Supra* 70 s. 5(4).

106. G. Coleman, *supra* 16.

107. (1991), 4 W.W.R. 151, 91 Sask. R. 162 (Sask. Q.B.), overturned on appeal, (1991), 4 W.W.R. 577, 80 D.L.R. (4th) 359 (Sask. C.A.).

108. S.B.C.A., R.S.S., 1978, c. B-10; C.B.C.A. *supra* 69 s. 29(1), and the O.B.C.A. *supra* 70 s. 27 are virtually identical.

109. *Ibid.*

110. National Policy 38 - Take-over Bids: Defensive Tactics (1986) 9 O.S.C.B. 4255; See chapter 4.6, *infra*.

111. R. Yalden, "Controlling the Use and Abuse of Poison Pills in Canada: *347883 Alta. Ltd. v. Producers Pipelines Inc.*" (1992), McGill L.J., 887.

112. (1993), A.J. No. 1043 No. 9301-18628 (QL) [unreported].

113. (1992) 4 B.L.R. (2d) 1 (O.S.C.).

114. *Ibid.* at headnote.

115. (Oct. 21, 1994), 17 O.S.C.B. 4963 (O.S.C.).

116. (Oct. 21, 1994), 17 O.S.C.B. 4971 (O.S.C.).

117. *Supra* 16 P. Dey & R. Yalden, at footnote 51 (citing the Pegasus Gold decision).

118. *Supra* 88.

119. *Supra* 111.

120. Re Canadian Jorex Ltd., *supra* 113; Lac Minerals, *supra* 115; MDC Corp., *supra* 116.

121. *Supra* 110.

122. *Supra* 50.

123. S. Beck & R. Wildeboer, "National Policy 38 as a Regulator of Defensive Tactics" (1987), Meredith Memorial Lectures: Acquisitions and Take-overs (Cowansville, PQ: Yvon Blais, 1987).

124. Ainsley Financial Corp. et al. v. O.S.C. (1994), 18 O.S.C.B. 43 (Ont. C.A.).

125. Sparling et al. v. Royal Trustco et al. (1984), 6 D.L.R. (4th) 682 (Ont. C.A.), appeal dismissed (1986), 2 S.C.R. 537 (S.C.C.).

126. 199 A. 2d. 548 (Del. 1964).

127. See for example: Martin et al. v. American Potash & Chemical Corp., 92 A.2d. 295 (Del. 1952); Bennett v. Propp, 187 A.2d. 405 (Del. 1962); Kors v. Carey, 158 A.2d. 136 (Del. Ch. 1960).

128. See for example Condec Corp. v. Lunkenheimer Co., 230 A.2d. 769 (Del. Ch. 1967); Sinclair Oil Corp. v. Levien, 280 A.2d. 717 (Del. 1971); Warshaw v. Calhoun, 221 A.2d. 487 (Del. 1966); Kaplan v. Goldsamt, 380 A.2d. 556 (Del. Ch. 1977); Petty v. Penntech Papers Inc., 347 A.2d. 140 (Del. Ch. 1975); Thompson v. Enstar Corp., 509 A.2d 578 (Del. Ch. 1984); Aronson v. Lewis, 473 A.2d. 805 (Del. 1984); Pogostin v. Rice, 480 A.2d. 619 (Del. 1984).

Note that in the decision of Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985), which was decided just before Unocal Corp., the Delaware courts did not apply the traditional business judgment rule (even though they claimed to). Rather, they applied a negligence standard; finding the directors liable for having exercised their duties negligently in the sale of the company. This decision was a signal from the Delaware courts that the era of Cheff's carefree attitude was coming to a close and that the perceived abuses of the leniency of the "business judgment rule" would no longer be tolerated in regards to takeover defenses.

129. *Supra* 60.

130. 493 A.2d. 946 (Del. 1985).

131. See for example: Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334 (Del. 1987); A.C. Acquisitions Corp. v. Anderson, Clayton, & Co., 519 A.2d 103 (Del. Ch. 1986); Shamrock Holdings Inc. v. Polaroid Corp., 559 A.2d 257 (Del. Ch. 1989); Polk v. Good, 507 A.2d. 531 (Del. 1986); Robert M. Bass Group Inc. v. Evans, Fed. Sec. L. Rep. (CCH) para. 93,924 (Del. Ch. 1988); Moran v. Household International Inc., 500 A.2d 1346 (Del. 1985); Grand Metro. Pub. Ltd. v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988); Gilbert v. El Paso Co., 575 A.2d 1131 (Del. 1990); Citron v. Fairchild Camera & Investment Corp., 569 A.2d 53 (Del. 1989); Revlon Inc. v. MacAndrews Forbes Holdings Inc., 506 A.2d 173 (Del. 1985); Jedwab v. MGM Grand Hotels Inc., 509 A.2d 584 (Del. Ch. 1986); Mills Acquisition Co. v. MacMillan Inc., 559 A.2d 1261 (Del. 1988); City Capital Assoc. Ltd. Partnership v. Interco Inc., 550 A.2d 35 (Del. Ch. 1988); TW Services v. SWT Acquisition Corp., Fed. Sec. L. Rep. 94,334 (Del. Ch. 1988); Stahl v. Apple Bancorp. Inc., 579 A.2d 1115 (Del. Ch. 1990).

132. *Supra* 131 Gilbert v. El Paso Co..

133. *Supra* 131 Revlon.

134. *Supra* 131 Revlon is an example. In this case it appeared that the primary reason to derail the takeover bid was to derail unrelated litigation. Another example of obviously self-interested acts by a directorship's use of hostile takeover defenses was in the case of Mills v. MacMillan, *supra* 131.

135. In A.C. Acquisitions Corp., *supra* 131, the court notes as a relevant factor when examining the usage of defensive strategies whether the utilization of the defense increases or limits shareholder choice.

136.*Supra* 131 Time is a situation in which the directorship were entitled to "say no" as they were pursuing long-term strategies for the corporation. That is, the directors are not entitled to "just say no", but are entitled to "say no for a good reason".

137.Frantz Manufacturing Co. v. EAC Industries, 501 A.2d 401 (Del. 1985).

138.A.C. Acquisitions Corp., *supra* 131.

139.Pillsbury Co., *supra* 131; A.C. Acquisitions Corp., *supra* 131.

140.*Infra* Chapter 5.1(i).

141.Fed. Sec. L. Rep. (CCH), para. 93,924.

142.Polaroid Corp., *supra* 131.

143.Newmont Mining Corp., *supra* 131.

144.*Supra* 131.

145.Moran, *supra* 131 and Time v. Paramount Communications, 571 A.2d 1140 (Del. 1990) are examples of great deference being granted to directors' actions as most of the directors were so-called "outside" directors. One of the key reasons that the Revlon directors (*infra* 153) were found to have breached their duties is that the board consisted entirely of individuals who were also senior executives of the company.

146.Buckhorn Inc. v. Ropak Corp., 656 F. Supp. 209, Fed. Sec. L. Rep. (CCH) para. 93,371 (SD Ohio 1987) (applying Delaware law); Hastings-Murtagh v. Texas Air Corp., 649 F. Supp. 479 (SD Florida 1987) (applying Delaware law); Black and Decker Corp. v. American Standard Inc., 682 F. Supp. 772 (D. Del 1988) (applying Delaware law).

147.See for example: Lewis v. Anderson, 477 A.2d 1040 (Del. 1984).

148.*Supra* 131.

149.Heckman v. Ahmanson, 214 Cal. Rptr. 177, 168 Cal. App. (3d) 119 (C.A.). The theoretical basis for tort liability for the greenmailer is advanced by Ronald D'Avis in the article: "Liability for Greenmailers: A Tort is Born" (1986), 19 Ind. L.R., 761.

150.A. Fleischer Jr., A. Sussman & H. Lesser, Takeover Defense vol. 2, 4th ed. (Englewood Cliffs, N.J.: Prentice Hall, 1990) at 588.

151.*Supra* 131.

152.Del. Code Ann., tit. 8 (Charlottesville, Virginia: Michie, 1983).

153.Revlon Inc. v. MacAndrews Holdings, Inc., 506 A.2d 173 (Del. 1986).

154.*Supra* 16.

155.See Grand Metropolitan Pub. Ltd Co. v. Pillsbury Co., *supra* 131.

156.*Supra* 128.

157.421 A.2d 906 (Del. Ch. 1980).

158.Stahl v. Apple Bancorp. Inc., *supra* 131.

159.535 A.2d 1334 (Del. 1987).

160.535 A.2d 840 (Del. 1987).

161.Time v. Paramount Communications, *supra* 144.

162.*Supra* 131.

163.Fed. Sec. L. Rep. (CCH), para. 94,401 (Del. 1989).

164.637 A. 2d 34 (Del. 1993).

165.*Supra* 152 s. 141(k).

166.*Ibid.*

167.Rules 14d-10, 14-1-14d-10 & 13e-4, C.F.R., tit. 17, s. 240 (1986).

168.*Supra* 15, Takeover Defense, 4th ed., vol. 1.

169.*Supra* 152 s. 211.

170.*Ibid.*

171.*Ibid.*

172.*Ibid.*

173.*Ibid* s. 102(4).

174.See *supra* 6 for a full discussion.

175.*Supra* 152 s. 102(4).

176.*Ibid.* s. 141(a).

177.*Ibid.* s. 271.

178.*Ibid.* s. 161.

179.378 A.2d 121 (Del. 1977).

180.See *supra* 102.

181.It was an amendment to the Securities Exchange Act of 1934, U.S.C., tit. 15, s. 781, 1988. The authority for federal regulation in this area is the so-called "commerce clause" which gives the federal government the right to regulate interstate commerce (U.S. Constitution, Art. 1, s. 8, cl. 3).

182.*Supra* 15 Am. Jur., vol. 19, 2nd ed., para. 2588.

183.See for example: Hanson Trust PLC v. SCM Corp., 774 F.2d 47 (2nd Cir. 1985); S.E.C. v. Carter Hawley Hale Stores, Inc., 760 F.2d 945 (9th Cir. 1985).

184.City Capital Assoc. Ltd. Partnership v. Interco, 696 F. Supp. 1551 (D. Del. 1988); RP Acquisitions Corp. v. Staley Continental Inc., 686 F. Supp. 476 (D. Del. 1988); BNS Inc. v. Koppers Co., 683 F. Supp. 458 (D. Del. 1988).

185.See for example Panter v. Marshall Field & Co., 646 F.2d 271, Fed. Sec. L. Rep. (CCH) para. 63,971 (7th Cir. 1981).

186.*Supra* 6.

187.*Supra* 6, at footnotes 13 and 15.

188.*supra* 16 P. Dey & R. Yalden.

189.*Supra* 6, at footnote 42.

190.K. Noble & A. Willis, "The Deals and the Deal-Makers", The Globe and Mail (Feb. 5, 1996, B1).

191.*Supra* 88, s. 89.

192.Note that *ibid* s. 88 expressly states that one may be exempted from the application of the O.S.A. if the securities laws of another jurisdiction apply.

193.*Supra* 76, Part XXlll of the by-laws.

194.*Supra* 70 s. 187.1.

195.*Supra* 69 s. 194.

196.*Supra* 76 By-Law 23.14.

197.*Supra* 88 s. 92(1)(b).

198.See Chapter 6.4(b).

199.S. 190 of O.B.C.A., *supra* 69; C.B.C.A. *supra* 70 s. 206; & O.S.C. Policies, 4 Can. Sec. L. Rep. (CCH) 815-422 (1984) s. 9.1 all directly regulate the second step of a two-tier bid to effectively make it a one-tier bid in two stages. Note also that the "oppression" remedy could be invoked to protect a minority shareholder who is being "squeezed-out" at less than full consideration for his or her shareholdings - see *supra* 69 s. 242 and *supra* 70 s. 247.

200.*Supra* 115.

201.See *supra* 183 for some of the recent American case authority which has severely limited the scope of this statute's application.

202.Institutional investors own over 50% of the shares in British public corporations, while individual shareholders own only about one-fifth of all outstanding common shares in same. See "Corporate Governance: Survey", The Economist (Jan. 29, 1994, Table 1).

203.In the fifteen year period leading up to spring 1985, The Take-Over Panel describes over three and a half thousand bids as having been announced.

204.*Supra* 202 Table 5.

205.Stock Exchange: Official Yearbook 1991-1992 (New York: Stockton Press, 1992) at 37-40.

206.*Supra* 50 & 51.

207.*Supra* 50 rule 9.

208.*Supra* 50 rule 27.

209.*Supra* 53.

210.P. Davies, The Regulation of Take-overs and Mergers (London: Sweet & Maxwell, 1976) is an example of this criticism.

211.*Supra* chapters 4.3 & 6.2(b).

212.See for example: "High Times For T. Boone Pickens", Time (March 4, 1985, 52). Note that this was the cover story.

213.*Supra* 6 (citing a Wall Street Journal article from 1985), notes that there were 30 takeovers and mergers worth over U.S. $1 000 000 000 each. In 1995 the all-time record for mergers and acquisitions was set by Wall Street, with the combined total of all of the major deals amounting to 458 million dollars U.S. (J. Smolowe, "Reap As Ye Shall Sow", Time (Feb. 12, 1996, 51)).

214.*Supra* 202 Table 5. This is a dramatic increase in comparison with just nine years earlier when the figure was 35.4% of the total shares listed on the exchange (NYSE 1983 Fact Book, vol. 52).

215.*Supra* 15 Takeover Defense, vol. 1, 4th ed., at 666.

216.See the NASDAQ 1994 FACT BOOK for exact figures.

217.*Ibid.* at Foreword.

218.*Supra* 181.

219.*Supra* 181 S.E.A., cl. 14(d)(1).

220.*Ibid.* cl. 14(d)(5).

221.*Ibid.* cl. 14(d)(6).

222.*Ibid.* cl. 14(d)(7).

223.*Ibid.* s. 78n(e).

224.*Ibid.* s. 78 n(d)(5).

225.Schreiber v. Burlington Northern, Inc. 472 U.S. 1 (U.S.S.C., 1985). This decision basically put to rest the decision of the Sixth Circuit Court of Appeal in Mobil Corp. v. Marathon Oil Co., 669 F.2d 366 (6th

Cir. 1981) which held that the courts were given jurisdiction under this provision to assess the substantive elements of takeovers and defenses to see if they were substantively "manipulative".

226.*Supra* 183.

227.*Supra* 183 Hanson Trust PLC, at 57.

228.*Supra* 183 S.E.C. v. Carter Hawley Hale Stores, Inc., at 950.

229.*Supra* 152.

230.*Supra* 183.

231.*Supra* 183.

232.*Supra* 152 s. 203 (a)(1)-(a)(3).

233.*Supra* 152 s. 203 subs. (c)3-(c)5.

234.*Supra* 152 s. 203 subs. (b)1-(b)6.

235.*Supra* 152.

236.The leading Delaware case is Weinberger v. UOP Inc., 457 A.2d 701 (Del. 1983). It expressly overrules the stricter tests of Singer v. Magnovox Co., 380 A.2d 969 (Del. 1977) & Tanzer v. International General Industries Inc., 379 A.2d 701 (Del. 1977).

237.See for example the leading case of Foss v. Harbottle (1843), 67 E.R. 189 (V.C. Ct.); Note that there has been some slight flexing of this rule in recent years - See: J. Ziegel et al., Partnerships and Business Corporations, vol. 2, 3rd ed. (Toronto: Carswell, 1994) at ch. 8.

238.*Supra* 53 at page 1004-1005; also, see decisions such as Hogg v. Cramphorn, *supra* 5, in which the court talks about "shareholders' constitutional rights".

239.*Supra* 70.

240.*Supra* 69.

241.*Supra* 152 s. 141(a).

242.*Supra* 28.

243.See the leading case of Barron v. Potter (1914), 1 Ch. 895, 83 LJ Ch. 646 (Ch. Div.).

244.See for example *supra* 131 Unocal Corp..

245.See for example Teck Corp., *supra* 60.

246."Name Your Poison", Time (April 29, 1985) at 61.

247.*Supra* 15 Am. Jur., 2nd ed., vol. 19, para. 2529.

248.H. Lambert, Till Death Do Us Part - *Bendix* vs. *Martin Marietta* (San Diego: Harcourt Brace Jovanovich, 1983) at 53.

249.*Supra* 15 J. Ziegel et al., at 627.

250.C. Farley, "Are They Worth All That Cash?", Time (Jan. 29, 1996, 34).

251.798 F.2d 882 (6th Cir. 1986).

252.*Supra* 15 Takeover Defense, vol. 1, 4th ed.

253.G. Jarrell, J. Brickley & J. Netter, "The Market For Corporate Control: The Empirical Evidence Since 1980 (1988), 2 Jour. Econ. Perspectives, 49.

254.*Ibid*. Note also that the authors of this study note that there are methodological shortcomings in the study which they cite which almost certainly underestimate the gains - i.e. the figure is at least 30% and may actually be much higher.

255.*Supra* 3.

256.M. Lipton, "Mileposts on the Takeover Trail - From Chicago to Delaware" (Nov. 9, 1989), John M. Olin Lecture, Woodrow Wilson School of Public and International Affairs, Princeton University.

257.See for example: D. Strangeland, "Why Are Anti-Takeover Devices Being Used?" (1995), Business Quarterly, 36.

258.*Supra* 253.

259.*Supra* 3.

260.J. Coffee Jr., "Regulating the Market For Corporate Control, A Critical Assessment of the Tender Offer's Role in Corporate Governance" (1985), 84 Col. L. Rev., 1145.

261.F. Scherer, "Corporate Takeovers: The Efficiency Arguments" (1988), 2 Jour. Econ. Perspectives, 69.

262.*Ibid*. at footnote 2.

263.R. Romano, "A Guide To Takeovers: Theory, Evidence, and Regulation" (1992), 9 Yale J. on Reg., 119.

264.It should be noted that some individuals try to argue that the most notorious of the abusive takeover practices - the front-loaded two-tier bid - is not really abusive or coercive at all. The argument made by the "Office of the Chief Economist, Securities and Exchange Commission" in the article "The Economics of Any-or-All, Partial, and Two-Tier Tender Offers" which dates from 1985, is that the overall share premium paid in a two-tier bid is virtually identical to that which is paid in an any-or-all bid, and therefore two-tier bids are not coercive. The data may be accurate; however, their conclusion that this fact means that two-tier bids are not coercive is not accurate. If we accept the "efficient capital markets" assumption of Easterbrook & Fischel (*supra*, endnote 3), then we must accept that bidders pay the "correct" price for shares in a takeover. Therefore, if the average premium in a two-tier bid and an any-or-all bid is 30% in both situations, then a two-tier bid must be coercive as one group of shareholders (the first 51%) receives above market value, while the shareholders "squeezed-out" at stage two of the transaction receive less than fair market value. In contrast, in an any-or-all bid one must assume that all of the shareholders are being paid the exact value (i.e. the bidder would not overbid, and if the bidder underbid, the shareholders would not tender or a rival bidder would join the fray and offer a "correct" price.)

265.In F. Easterbrook & D. Fischel's 1982 article "Auctions and Sunk Costs in Tender Offers" (published in 35 Stan. L.R., 1) the argument is advanced that there should be a complete prohibition on the usage of defensive tactics, even ones that are designed to cause a share auction. The rational they advance is one based on a normative model from law and economics which argues that, while a "share auction" may result in a higher return to the shareholders in the particular instance, it will act as a deterrent to takeovers and thus harm shareholders as a whole. R. Gilson, in his article "Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defense" (1982), 35 Stan L. Rev., 51, effectively refutes this theoretical model by pointing out: the "sunk costs" are grossly overstated by the forementioned model, this ban on defenses designed to delay one bid while a higher one is seeked runs counter to Easterbrook & Fischel's argument that in a free market corporate assets will naturally "move" to their most efficient usage (i.e. if a rival bidder is willing to pay more is that not because their intended usage for the corporate assets is more efficient than the original bid?), and that the "failed" original bidders often make fortunes through selling their shares to the ultimately successful bidder. For example, almost all of Mesa Petroleum Co.'s takeover bids were "failures", yet they netted the raider hundreds of millions of dollars this way (see the Time article cited in endnote 238, *supra*).

266. *Supra* 60.

267. *Supra* 65.

268. Recommendations made in a recent C.B.C.A. discussion paper include an outright prohibition on the usage of takeover defenses unless there is shareholder approval of same. See: C. Bernand & L. Tasse, C.B.C.A. Discussion Paper: Take-Over Bids (unpublished, Feb. 1996) at para. 225.

269. *Supra* 253.

270. *Supra* 210.

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