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Medication in Moderation: A Case for Adopting Canada's Limitations on Poison Pills in the U.S. and U.K.

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Medication in Moderation: A Case for Adopting Canada's Limitations on Poison Pills in the U.S. and U.K.

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Abstract: Ever since shareholder rights plans or "poison pills" were devised, there has been staunch disagreement about whether the measures overinsulate management and harm returns or whether such defenses are necessary to ensure shareholders get the best possible deal in a change of control transaction. Responding to a inter-provincial regulatory dispute, Canada has recently amended its takeover regulations to create an extended deposit period accompanied by a majority-tender requirement which has enhanced target-board negotiating power. This Note argues that such a change would benefit both the takeover regimes of both the United States and United Kingdom by making the former more takeover friendly and the latter less so.

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The author would like to thank his family their support and esteemed colleague Kara Cooper for her valuable feedback. All errors and omissions in this paper remain with the author.

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I. INTRODUCTION

> "Popular opinions . . . are often true, but seldom or never the whole truth. . . . [E]very opinion which embodies somewhat of the portion of truth which the common opinion omits, ought to be considered precious, with whatever amount of error and confusion that truth may be blended."
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> J.S. Mill, On Liberty, 85–86

Since 1983, a cold war has been fought over whether corporate boards may defend themselves against hostile takeovers. Law and economics scholars and institutional shareholders vehemently oppose defensive mechanisms, while other scholars, corporate attorneys, and management claim they must be able to delay or defeat a takeover to fulfill their fiduciary duties. Regulators in the United Kingdom allow boards hardly any defensive tactics while the courts in the United States allow management practically impenetrable takeover defenses. Canadian regulators, facing regulatory divergence in different provinces over the extent to which boards could adopt defensive measures, have renewed their role as defenders of moderation. They have promulgated rules with the potential not only to harmonize the contradictory policies among provincial regulators, but also to provide the United States and the United Kingdom—not to mention academics and practitioners—a means to achieve détente in the fight over who has control in a hostile takeover. In short, the Canadian Rule offers an elegant solution that maintains board negotiating ability while empowering shareholders.

The most important and controversial defensive measure a board may employ when facing a hostile takeover is a "poison pill" or "shareholder rights plan." It is a defensive measure that an American or Canadian corporate board may adopt in order to resist an acquiring entity's efforts to gain control of the company in a tender offer.[1] The typical pill works by providing all shareholders *other than acquirer* with the right to obtain more shares at a below-market price.[2] Shareholders eagerly exercise these rights, diminishing the economic value of an acquirer's shares and diluting the percentage stake the acquirer owns in the target firm.[3] The poison pill prevents takeover by making it economically infeasible for an acquirer to buy enough shares to gain a controlling stake in the target corporation.[4]

Part II of the Note introduces the academic debate between those who believe boards need shareholder rights plans to fend off hostile takeovers while maximizing shareholder value and those who believe that shareholders always know best when deciding to tender in a takeover bid. Part III

[1] 19 AM. JUR. 2D CORPORATIONS § 2186 (2015).
[2] *Id*.
[3] *Id*.
[4] *Id*.

explains the general workings of the Canadian takeover regime and how regulatory interventionism brought about the proposed amendments. After considering how the new rules benefit the Canadian system, Part IV sketches the American takeover regime and highlights the doctrinal and statutory developments that have caused an overabundance of board discretion that leaves managers entrenched and shareholders with few options. The Canadian rules are analyzed in the American context, and while not fully satisfying either the pro-board or pro-shareholder camps, the new rules seem to offer an elegant solution that maintains board negotiating ability while empowering shareholders. Part V considers the British takeover regime and offers the Canadian rules as a solution to the United Kingdom's persistent problem that target boards are always in a weaker negotiating position relative to the acquirer.

I. JUST WHAT ARE WE FIGHTING OVER? SHAREHOLDERS VERSUS BOARDS

First, a key distinction in Anglo-American corporate law: in the United States, United Kingdom, and Canada, a tender offer is when an acquiring company offers to buy shares from current shareholders with the goal of amassing enough shares to gain control of a company by electing new corporate directors.

This is different from the American statutory "merger" where an acquiring company offers buy shares of the target after which the target will cease to exist as a separate corporate form. In most American jurisdictions, a majority of shareholders of the target corporation will need to vote on the transaction.[5] In Canada, similar statutory transactions are called "amalgamations" or "plans of arrangement," and they usually require approval by two-thirds of target shareholders.[6] In the United Kingdom, a similar procedure called a "scheme of arrangement" requires 75% target shareholder approval.[7] While UK schemes of arrangement will be mentioned briefly at the end of this paper, the primary focus is on tender offers, and in particular

[5] In a merger, the transaction is governed by Delaware General Corporate Law ("DGCL"), DEL. CODE ANN. tit. 8, § 251 (West 2014). When considered together, subsections 251(c) and (f) provide that a majority of outstanding shares of a target corporation must vote to approve a merger transaction (the most common form of takeover). This is the most common rule. *Compare* MODEL BUS. CORP. ACT § 12.02(e) (AM. BAR ASS'N 2011) (majority vote), *and* CAL. CORP. CODE § 1001 (West 2014) (majority vote), *with* 805 ILL. COMP. STAT. 5/11.20(a) (2014) (two-thirds majority unless certificate of incorporation specifies otherwise).

[6] *See, e.g.*, Canada Business Corporations Act*, R.S.C.* 1985, c-44, s 183(5) (Can.); Ontario Business Corporations Act, R.S.O. 1990, c B.16, s 176(4) (Can.). This paper will not discuss Canadian plans of arrangement because, unlike in the United Kingdom, arrangements in Canada likely cannot be used to accomplish takeovers. *See* JENNIFER PAYNE, SCHEMES OF ARRANGEMENT: THEORY, STRUCTURE AND OPERATION 140 (2014).

[7] PAYNE, *supra* note 6, at 21.

hostile tender offers where the acquirer does not have the support of the target's board of directors. Since a poison pill is the best way for a target board to thwart a tender offer and subsequent change of directors, it is the gold standard of takeover defenses.

The poison pill was conceived following the takeover craze of the 1970s, and academics have argued over the device's utility (or lack thereof) ever since.[8] What I will call the "board-centric" side seeks to insulate boards from "activist" shareholders "interfering" with management's running of the company or its attempts to maximize shareholder value in any change of control transaction. Supporters of the board-centric view argue that poison pills and other takeover defenses properly protect the ability of the board of directors to maximize shareholder value while reducing agency costs.[9] "Shareholder-centric" academics and financial institutions view board defensive measures like poison pills as merely tools used to entrench and enrich underperforming management.[10]

A. Corporate Boards or Bust

Board-centric academics and corporate lawyers criticize their shareholder-centric counterparts for overemphasizing the maximization of shareholder value arguing that it has negative consequences for firms and the wider economy.[11] They argue that insulating corporate boards is necessary to increase director sensitivity to pressure by shareholders and market forces.[12] Unfortunately, such outsized shareholder influence leads to excessive

[8] Frank Allen & Steve Swartz, *Lenox Rebuffs Brown-Forman, Adopts Defense*, WALL ST. J., June 16, 1983, at 2 (relating the details surrounding the primogenitor shareholder rights plan, the first "poison pill"). *See also* John Armour, Jack B. Jacobs, & Curtis J. Milhaupt, *The Evolution Of Hostile Takeover Regimes In Developed And Emerging Markets*, 52 HARV. INT'L L.J. 219, 241 (2011) (explaining the macroeconomic and regulatory causes of the 1970s takeover wave and the reasons why the poison pill emerged as America's takeover defense of choice).

[9] *See* Martin Lipton & Paul K. Rowe, *The Inconvenient Truth About Corporate Governance: Some Thoughts on Vice-Chancellor Strine's Essay,* 33 J. CORP. L. 63, 65–66 (2007). Lipton and Rowe argue vociferously that shareholders have inadequate information and insufficient time to make adequately informed long-term investment decisions; they declaim as exaggerated the alleged "agency problem" in which the interests of corporate directors and shareholders impermissibly diverge, and advocate renewed adherence to board-centric corporate governance. To explain why Delaware courts go along with this view, see Bernard Black & Reinier Kraakman, *Delaware's Takeover Law: The Uncertain Search for Hidden Value*, 96 NW. U. L. REV. 521 (2002) (detailing a "hidden value" model of takeovers to explain Delaware judicial decision making regarding mergers and acquisitions).

[10] *E.g.*, Matthew E. Souther, *The Effects of Takeover Defenses: Evidence From Closed-End Funds*, 119 J. FIN. ECON. 420, 420 (2016) (finding that in closed-end funds the use of takeover defenses negatively impact firm value while financially benefitting managers).

[11] *See* Lynne L. Dallas, *Short-Termism, the Financial Crisis, and Corporate Governance* 267 (University of San Diego Legal Studies Research Paper No. 12-078, 2012), http://ssrn.com/abstract=2006556.

[12] *See* LAWRENCE E. MITCHELL, THE SPECULATION ECONOMY: HOW FINANCE TRIUMPHED OVER INDUSTRY 1–7 (2007), http://ssrn.com/abstract=1017923.

corporate risk-taking.[13] Some scholars argue that this partially caused the Great Recession in the United Kingdom.[14] Regardless, many attribute the ills of shareholder activism to the increasing activities of "[m]oney manager intermediaries constitut[ing] a supermajority of those wielding actual stockholder rights rather than the long-term investors whose money is actually invested."[15] In other words, board-centric academics argue that those voting the shares might have different interests from those who actually own them.

In the context of a hostile takeover, many corporate boards are leery because they know that activist shareholders (like mutual funds, pension funds, and hedge funds) are looking to improve short-term results.[16] Unfortunately, the short-term strategy usually means the target company's returns will suffer as value is "extracted" at the expense of long-term fiscal stability.[17] While it is true that corporate directors often make quarterly share price increases their top priority, directors' self-interest in keeping the company solvent so they can keep their jobs moderates their temptation to pursue short-term gains at all costs. Still, corporate directors may worry that without unilateral discretion to adopt a poison pill, institutional investors might vote to tender their shares on a whim for a quick profit even though the acquirer has no interest in improving the health of the target. But this is not the only kind of harm that target boards face from potential activist acquirers.

It is also possible that activist acquirers are not interested in maximizing shareholder value in the traditional sense. Law Professors Henry Hu of the University of Texas and Bernard Black of Northwestern University point out that money manager investors frequently hedge their investments in corporations with derivatives and debt-equity swaps, which allows them to separate their control rights from the incentives of owning equities.[18]

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13 *See* William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 656 (2010) (arguing that investors' value-maximizing incentives and incomplete perception of risk relative to managers makes them even less able to judge the appropriateness of risk-taking when compared with the board).

14 David Kershaw, *The Illusion of Importance: Reconsidering the UK's Takeover Defence Prohibition*, 56 INT'L & COMP. L.Q. 267, 269 (2007) (citing Martin Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. PA. L. REV. 1 (1987)).

15 Leo E. Strine, Jr., *Can We Do better by Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law*, 114 COLUM. L. REV. 449, 455–56 (2014).

16 *See* Carl Ackermann, Richard McEnally & David Ravenscraft, *The Performance of Hedge Funds: Risk, Return, and Incentives*, 54 J. FIN. 833, 834 (1999).

17 *See* Alon Brav et al., *Hedge Fund Activism: A Review*, 4 FOUND. & TRENDS IN FIN. 185, 222 (2010) (finding target operating profitability declines upon acquisition and does not recover until two years later, if at all).

18 Henry T. C. Hu & Bernard Black, *Equity and Debt Decoupling and Empty Voting II: Importance and Extensions*, 156 U. PA. L. REV. 625, 626 (2008) (describing the ways in which control and equity interests can be decoupled such that large shareholders benefit by exercising their control to the detriment of the company and other shareholders, including during takeovers).

Once economic and control rights are separated, institutional investors will focus more on short-term rather than long-term value.[19] Such investors may seek to take over companies for a short period of time simply to engage in arbitrage.[20] These kinds of acquirers have motives totally divorced from improving shareholder value over the long term.[21] Still, law and economics scholars favoring total shareholder control in hostile takeovers might reply that even if Hu and Black are correct that arbitrage and misaligned institutional investor incentives pose a problem, it is not serious enough to warrant giving boards the power to completely insulate themselves from hostile takeover using shareholder rights plans.[22]

In response to these arguments that the rise of institutional investors should justify the ability of directors to maintain a poison pill without a shareholder vote, law and economics scholars engage in a flanking maneuver and attack a different justification for allowing boards to use poison pills, namely "substantive coercion." The doctrine of substantive coercion posited that boards should have the ability to address the risk posed by fully-informed-but-rather-nervous shareholders mistakenly accepting a hostile bid that undervalued the company.[23] Professors Ronald Gilson and Jeffrey Gordon argue that if these well-informed institutional investors and arbitrageurs really are as prevalent as board-centric scholars warn, then "substantive coercion" should no longer pose a problem.[24] Where institutional investors already hold a large stake in the target, they may have a superior understanding of both the target's business prospects and the relative value of an offer from a hostile acquirer. In such a situation, Gilson and Gordon would argue that there is no danger of "substantive coercion" because the well-informed and experienced institutional investors are in no danger of "mistakenly" selling their shares. Hence, Delaware case law giving corporate boards a free hand to adopt poison pills would be called into question because those cases rely in part on the danger of substantive coercion as

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19 *Id.*

20 *See* Bernard Black*, Bernard S., Equity Decoupling and Empty Voting: The Telus Zero-Premium Share Swap* (Northwestern Law & Econ. Research Paper No. 12-16, 2012), *reprinted in* M&A Lawyer, October 2012, at 1, 4–8, http://ssrn.com/abstract=2150345.

21 *See* Jordan M. Barry, et al., *On Derivatives Markets and Social Welfare: A Theory of Empty Voting and Hidden Ownership* 7 (Stanford Law and Econ. Olin Working Paper No. 433, Aug. 22, 2012), http://ssrn.com/abstract=2134458.

22 Mark J. Roe*, Corporate Short-Termism—In the Boardroom and in the Courtroom*, 68 BUS. LAW. 978, 1005–06 (2013).

23 Ronald J. Gilson & Jeffrey N. Gordon, *Agency Capitalism: Further Implications of Equity Intermediation* 22–23 (European Corporate Governance Institute (ECGI) Law Working Paper No. 239/2014; Stanford Law and Econ. Olin Working Paper No. 456; Columbia Law and Econ. Working Paper No. 46, Feb. 1, 2014), http://ssrn.com/abstract=2359690.

24 *Id*. *See generally* Usha Rodrigues, *Corporate Governance in and Age of Separation of Ownership from Ownership*, 95 MINN. L. REV. 1822 (2010) (providing an in-depth comparison of the conflicts that can arise between long-term shareholders like index and pension funds to more activist short-term shareholders like hedge funds).

justification for using a shareholder rights plan.[25]

Still, Gilson and Gordon do not consider the enormous agency problems identified by Hu and Black that arise when a "shareholder" holds only control rights and is betting against the target company in a takeover because the shareholder is in league with the hostile acquirer. Without a poison pill, such phantom shareholders can and will vote in favor of a takeover to the detriment of all other shareholders without suffering negative economic consequences. Indeed, Hu and Black show that decoupling control and equity stakes misaligns incentives so that shareholders might look to sell even when the share price is below what any normal shareholder would accept (i.e., at a price below what would be acceptable to a person holding both the legal and economic interests in the shares).[26] As Chief Justice Strine puts it, "institutional investors have emerged who seem to be motivated by a desire for engagement for reasons unrelated to investment value."[27] Plus, even when activist acquirers like hedge funds are interested in maximizing investment value, their activism imposes significant costs. Shareholder votes are time consuming, inefficient, and expensive—the only ones with the time to be activists are the intermediary money managers and hedge fund managers.[28]

American jurists are not the only ones questioning the unbridled model of shareholder primacy. The idea that it may be detrimental to focus solely on maximizing shareholder has gained some traction in Canada and the United Kingdom.[29] In fact, Hu and Black have a Canadian counterpart who wanted to use the new regulations to restrict "empty voting" and decou-

[25] Unocal v. Mesa Petroleum, 439 A.2d 946, 955 (Del. 1985) (holding that courts may leave in place defensive measures like poison pills under the business judgment rule to the extent that such measures are "reasonable in relation to the threat posed").

[26] *See* Hu & Black, *supra* note 17, at 631–636 (describing the ways in which control and equity interests can be decoupled such that large shareholders benefit by exercising their control to the detriment of the company and other shareholders, including during takeovers).

[27] *See* Strine, *supra* note 15, at 455–56.

[28] *See* Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1740 (2006) (conceding that shareholder votes on takeovers are inherently necessary but not indicative of some wider need to expand shareholder voting to other subjects properly and efficiently within the sole discretion of the board).

[29] *See* Carol Liao, *Corporate Governance Reform for the 21st Century: A Critical Reassessment of the Shareholder Primacy Model*, 43 OTTAWA L. REV. 187 (2013) (arguing the law and economics "shareholder primacy model encourages corporate behavior that perpetuates the likelihood of future crises" and suggesting reforms to the core features of corporate structures as a solution); Michael Marin, *Disembedding Corporate Governance: The Crisis of Shareholder Primacy in the UK and Canada*, 39 QUEEN'S L.J. 223 (2013) (arguing for corporate reform on the socialist philosophy and legal theory). One last point is that shareholder-centric systems, or "outsider systems," like that of the United Kingdom, tend to make companies slightly less stable "because managers are not free to build up cash reserves that could help protect jobs during temporary economic downturns, because they are under constant pressure to deliver short-term shareholder value." Helen Callaghan, *Economic Nationalism, Network-Based Coordination, and The Market for Corporate Control: Motives for Political Resistance to Foreign Takeovers* 5 (MPIfG Discussion Paper, No. 12/10, 2012), http://hdl.handle.net/10419/67720.

pling.[30] Canadian and American academics criticize American law and economics scholarship for downplaying the "significant proportion of firms" that "experience losses as a result of hedge fund activism" and for "overlook[ing] . . . the possibility that whatever wealth is created by hedge fund activism may reflect only a wealth transfer from bondholders, employees, or other claimants."[31] One pair of scholars went so far as to refute (if not deride) Professor Bebchuk's most recent 2014 paper as a misadventure in dummy variables and spurious causal inferences.[32] Moreover, some Canadian scholars in the "stakeholder" school of thought fiercely contest the idea that directors are entrenched at all, pointing to the fact that most takeover agreements improve share prices so substantially that directors cannot wait to cash in their stock options.[33] This can change "hostility into a welcome mat," even if it is not in best the long-term interests of investors, the company, or employees.[34]

Finally, and most importantly, there is substantial evidence that being able to resist a hostile takeover is beneficial for shareholders. Implementing a shareholder rights plan forces the acquirer to pay the added value that accompanies gaining control of the target, the "control premium."[35] This premium is 5–10% higher when a company has adopted a poison pill.[36] In other words, the bidding contest for control of the target company frequently "culminates in an acquisition on terms superior to the initial hostile offer."[37]

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[30] Robert E.P. Shaw, *What We Don't Know Can Hurt Us—Ontario's Regulation of Empty Voting and Hidden (Morphable) Ownership*, 29 BANKING & FIN. L. REV. 517, 519–21 (2014).

[31] John C. Coffee & Palia Darius, *The Impact of Hedge Fund Activism: Evidence and Implications* 3–4 (European Corporate Governance Institute Law Working Paper No. 266/2014; Columbia Law and Econ. Working Paper No. 489, 2014), http://ssrn.com/abstract=2496518. For a similarly skeptical continental European perspective, see generally Luca Eniques & Matteo Gatti, *Creeping Acquisitions in Europe: Enabling Companies to Be Better Safe than Sorry* (European Corporate Governance Institute Law Working Paper No. 264/2014; Oxford Legal Studies Research Paper No. 69/2014, 2014), http://ssrn.com/abstract=2492158. When researchers focused on the performance of U.K. companies they found "there is no clear evidence of improved post-acquisition performance." Christian Tuch & Noel O'Sullivan, *The Impact of Acquisitions on Firm Performance: A Review of the Evidence*, 9 INT'L J. MGMT. REVIEWS 141, 149 (2007).

[32] *See* Yvan Allaire & Francois Dauphin, "*Activist" Hedge Funds: Creators of Lasting Wealth? What Do the Empirical Studies Really Say?* 6 (July 16, 2014), http://ssrn.com/abstract=2460920. Even economists concede that event studies have statistical "shortcomings." Marina Martynova & Luc Renneboog, *A Century of Corporate Takeovers: What Have We Learned and Where Do We Stand?*, 32 J. BANKING & FIN. 2148, 2512 (2008).

[33] Letter from Yvan Allaire, Exec. Chair of the Institute for Governance to the Ontario Securities Commission and *Autoritê des marchés financiers* regarding CSA Request for Comment on Proposed National Instrument 62-203 (June 26, 2013), http://www.osc.gov.on.ca/documents/en/Securities-Category6-Comments/com_20130627_62-203_insituegovprivate_en.pdf.

[34] *Id.*

[35] BLACK'S LAW DICTIONARY (10th ed. 2014).

[36] *See* John Laide, *Poison Pill M&A Premiums*, SHARKREPELLANT (Aug. 30, 2005), https://www.sharkrepellent.net/pub/rs_20050830.html.

[37] Carmody v. Toll Bros., 723 A.2d 1180, 1186 (Del. Ch. 1998).

The economic benefits of rights plans for shareholders are well-recognized by American courts, which makes them "extremely reluctant to order the redemption of poison pills on fiduciary grounds."[38]

Overall, the board-centric camp has compelling arguments from experience, and their perspective is shared by most Delaware judges, if not most judges generally. They raise issues regarding empty voting and post-takeover firm performance that those favoring shareholders have yet to satisfactorily answer.

B. Shareholders Claim Primacy

Shareholder-centric academics and institutional investors counter by arguing that anti-takeover measures like poison pills and classified or "staggered" boards merely entrench incumbent management while denying shareholders the opportunity to benefit from a potential takeover.[39] Law and economics scholars concede that protecting boards from removal may help them attain higher acquisition premiums for shareholders,[40] but they argue that "incumbents might use whatever additional power comes with such protection to extract side payments for themselves rather than higher premia for shareholders."[41] Additionally, Professor Lucian Bebchuk argues that policies insulating managers from shareholders will give them less incentive to serve shareholder interests, particularly when managers know they can thwart any hostile takeover attempt with a poison pill, "or at least . . . extract a good deal for themselves."[42] Without the "disciplinary threat" of a takeover, Bebchuk argues, management agency costs will increase and corporate performance will decrease.[43]

In response to Justice Strine's criticisms, the shareholder-centric academics—including Professor Bebchuk—have produced studies purportedly

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[38] *Id.*

[39] *See* Lucian A. Bebchuk & Allen Ferrell, *A New Approach to Takeover Law and Regulatory Competition*, 87 VA. L. REV. 111, 113–14 (2001); *see also* Lucian A. Bebchuk & Alma Cohen, *The Costs of Entrenched Boards*, 78 J. FIN. ECON. 409 (2005) (finding poison pills in combination with staggered boards over-insulate directors causing a decrease in firm value); *but see* Michael D. Frakes, *Classified Boards and Firm Value*, 32 DEL. J. CORP. L. 113 (2007) (agreeing classified boards reduce firm value on average while questioning the Bebchuk's underlying empirical methods and finding negative effects only among the quintile of largest firms and positive effects on firm value in the quintiles containing smaller firms).

[40] *See* Robert Comment & G. William Schwert, *Poison or Placebo? Evidence on The Deterrence and Wealth Effects of Modern Antitakeover Measures*, 39 J. FIN. ECON. 3, 38 (1995) (finding "takeover premiums are higher when target firms are protected by state laws or [poison] pills suggest[ing] that the relative bargaining positions . . . are altered by these antitakeover devices, raising . . . gains to the target").

[41] *See* Bebchuk & Cohen, *supra* note 37, at 415–17.

[42] Lucian A. Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973, 993 (2002).

[43] *Id.* at 994.

showing shareholder activism does not hurt long-term returns.[44] In addition, these scholars claim there is no evidence that institutional investors engage in "pump-and-dump" patterns of activism.[45] Still, it is unclear whether Bebchuk's study reflects situations in which equity and control stakes have been bifurcated. In particular, Bebchuk and his coauthors use historical stock price, balance sheet, cashflow, and news headlines, but it does not seem as though they have accounted for the kind of cash-settled equity swaps and derivatives that can be used to get economic ownership without the formal exchange or sale of securities.[46] Hence, the law and economics scholarship may underrepresent the dangers posed by predatory acquirers and short-term focused arbitrageurs, which would lead scholars like Bebchuk to underestimate the importance of giving target boards the ability to resist a hostile takeover.

Other researchers sympathetic to shareholder interests vis-à-vis boards take a completely different tack, positing that the "short-termism" argument overlooks the economic fundamentals of the U.S. market. In particular, Professor Mark J. Roe of Harvard Law School argues that any distortions caused by short-termism holdings are offset by venture capital and private equity markets, and that high-frequency trading data has created an illusion that holding periods have shortened when in reality major shareholding institutions like mutual and pension funds still hold their shares for the long-term.[47] Still, Roe does not argue that short-termism is not a problem, only that the current level of protection afforded by American law is more than sufficient and that threats of short-termism should not be used to further expand board discretion.[48] Roe necessarily concedes that shareholder rights plans must play a role in defending against investors motivated by goals other than maximizing investment value.

To be sure, the body of law and economics scholarship that underlies the shareholder primacy model and its supporters is substantially larger than that of the pro-board scholars and practitioners. Still, using linear equations to explain complex phenomena without accounting for important differences (e.g., industry type) or data discrepancies (e.g., not correcting for companies that were liquidated post-takeover) does raise legitimate ques-

[44] Lucian A. Bebchuk, Alon Brav & Wei Jiang, *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085, 1085 (2015). *See generally* Lucian A. Bebchuk, *The Myth That Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637 (2013).

[45] This refers to situations where shareholders push for increased profits or shareholder distributions and sell their stake before the inevitable period of abnormal negative long-term returns sets in, **not** to the fraudulent practice of making false and misleading statements to the marketplace to artificially inflate a microcap stock. *See "Pump-and-dumps" and Market Manipulations*, S.E.C. FAQ (last visited Feb. 14, 2015), http://www.sec.gov/answers/pumpdump.htm.

[46] *See* Hu & Black, *supra* note 18, at 635.

[47] *See* Roe, *supra* note 22, at 1000.

[48] *Id.* at 1005–06.

tions.[49] Nevertheless, the quantity of academic research supporting shareholder primacy tempers most assertions that correlation and causation may have been confused.

C. Charting a Third Way

Despite each side's assertion of a monopoly on truth, it may be the case that both the shareholder-centric and board-centric camps have valid claims, despite their dire predictions about their opponents' policies. Indeed, Delaware Chief Justice Leo Strine, has argued that pro-board of directors "insulation advocates" and supporters of "shareholder driven direct democracy" are both too extreme in their policy prescriptions.[50] Justice Strine suggests compromise modifications to American corporate law wholly satisfying to neither side of the board-shareholder academic divide; these changes are reminiscent of the recently amended Canadian system.[51] Hence, it would seem appropriate to consider what lessons may be learned from the recently amended Canadian securities regime.

III. THE CANADIAN SYSTEM OF HOSTILE TAKEOVERS

The Canadian policy on poison pills ("shareholder rights plans" or "SRPs") and takeover bids has an advantage over both the British and American policy regimes because Canada protects shareholder choice while preserving management bargaining ability. With minor modification, the Canadian policy can be readily adapted to both the American and British contexts to the benefit of both systems.[52]

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[49] *See* Strine, *supra* note 15, at 461–64 .

[50] *Id.* at 449.

[51] *Id.* at 498–99. For instance, now-Chief Justice Strine suggests that corporate boards should be unclassified so that there is always less than a year before the bidder can launch a proxy fight to gain control of the board (which is possible even with less than fifty percent of shares because of plurality voting). *Id.* This has similar effect to the Canadian 120-day maximum length for poison pills, granted it is only one-third the length. Both provisions give target boards a finite period of time to negotiate with a determined hostile acquirer before facing a shareholder. In Canada, shareholders vote on whether to approve maintaining the poison pill, and under Strine's rule the same thing effectively happens when the existing shareholders decide whether to side with the acquirer in a proxy fight (who, if victorious, will take control of the board and rescind the pill).

[52] Canadian Securities Administrators, ONT. SEC. COMM'N, *CSA Notice 62-306: Update on Proposed National Instrument 62-105* Security Holder Rights Plans *and AMF Consultation Paper* An Alternative Approach to Securities Regulators' Intervention in Defensive Tactics (Sept. 11, 2013), http://www.osc.gov.on.ca/documents/en/Securities-Category6/rule_20140911_62-306_update-holder-rights-plan.pdf. The Canadian Securities Administrators (CSA) is a voluntary cooperative body that devises consensus based policy recommendations with the goal of enactment by the independent territorial securities commissions. *Overview*, CANADIAN SECURITIES ADMINISTRATORS, http://www.securities-administrators.ca/aboutcsa.aspx?id=45 (last visited Nov. 9, 2014).

A. The Canadian Legal Apparatus: Statutes, Regulators, and Regulations

The Canadian constitution constrains the federal government such that the Canadian securities regime is governed largely by provincial statutes and enforced by provincial officials.[53] Unlike the American regime, which relies on state courts and corporate law to determine the validity of takeover defenses and SEC regulations to moderate certain aspects of the takeover process, each Canadian province has its own statute setting up an independent securities commission capable of promulgating rules and adjudicating disputes.[54] In sharp contrast to Delaware's hegemony over American corporate law, no single Canadian territory or province has a monopoly on incorporating businesses, so variations and contradictions among provincial regulators and regulations are more likely to cause friction.[55]

One key feature of the Canadian system is that securities regulators have the power to enact a wide variety of orders if they deem it to be in the public interest.[56] For instance, the prototypical Securities Act (Ontario), R.S.O. 1990, c S.5, sec 127(1), gives the Ontario Securities Commission the power to exercise this "public interest jurisdiction" to command, *inter alia*, that "trading in any securities by or of a person or company or that trading in any derivatives by a person or company cease permanently or for such period as is specified in the order."[57] This particular order is called a "cease

[53] It is unclear whether a national scheme of securities regulation would be constitutional in Canada. In an advisory opinion, the Canadian Supreme Court held that the Government's proposed securities act "as presently drafted is not valid under the general branch of the federal power to regulate trade and commerce under s 91(2) of the Constitution Act, 1867." Reference Re Securities Act, [2011] 3 S.C.R. 837, ¶ 134 (Can.). The Court opined that "Parliament cannot regulate the whole of the securities system simply because aspects of it have a national dimension," but the Court left open the possibility for a co-operative federalism type solution while refusing to speculate as to the permissible contours of such a scheme. *Id.* ¶¶ 7–10. By most accounts, it seems Canadian securities regulation will remain at the state or territorial level for the foreseeable future.

[54] In the provinces, Commissions are established unless otherwise noted: Securities Act (Alberta), R.S.A. 2000, c S-4, § 11 (Can.); Securities Act (British Columbia), R.S.B.C. 1996, c 418, § 4, (Can.); Securities Act (Manitoba), C.C.S.M. 2012, c S50, sec 2(1) (Can.); Securities Act (New Brunswick), S.N.B. 2004, c S-5.5, § 4 (Can.); Securities Act, R.S.N.L. 1990, c S-13, § 3 (Can.) (establishing Superintendent of Securities); Securities Act (Ontario), R.S.O. 1990, c S.5, sec 2.1 (Can.); Securities Act (Prince Edward Island), R.S.P.E.I. 1988, c S-3.1, § 13(2) (Can.) (establishing Superintendent of Securities); Act Respecting the *Autorité des Marchés Financiers* (Quebec), L.R.Q. 2004, c 37, s 90 (Can.); Securities Act (Saskatchewan), S.S. 1988-89, c S-42.2, § 3.1(1) (Can.). In the territories, Superintendents of Securities are appointed by their respective Finance Ministers: Securities Act (Northwest Territories), S.N.W.T. 2008, c 10, § 13 (Can.); Securities Act (Nunavut), S.Nu. 2008, c 12, § 13 (Can.); Securities Act (Yukon), SY 2007, c 16, § 13 (Can.).

[55] *See* Ian C. Wildgoose Brown, *Hard to Swallow: The Canadian Poison Pill from an American Perspective*, 36 SETON HALL LEGIS. J. 297, 309 (2012).

[56] Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission), [2001] 2 S.C.R. 132, ¶ 39 (Can.).

[57] *FAQ*, ONT. SEC. COMM'N, http://www.osc.gov.on.ca/en/19855.htm (last visited Feb. 14, 2015).

trade."[58] Provincial securities regulators may issue cease trade orders against a company for a variety of reasons, including: failure to or tardy filing of periodic disclosures, filing deficient disclosures, or when the public interest requires.[59] In the hostile takeover context prior to the adoption of the most recent amendments, if a provincial securities commission decides a pill is not in the public interest, then it enters a cease trade order preventing a target company's shareholders from redeeming their share warrants or purchasing target stock at a discount—this has the effect of allowing the acquirer to buy the stock on the open market without being subject to the pill.

Facing the difficulty of coordinating across ten provinces and three territories, the various securities regulators decided to seek uniformity and formed a cooperative organization called the Canadian Securities Administrators (CSA).[60] The CSA describes itself as an "umbrella organization of Canada's provincial and territorial securities regulators whose objective is to improve, coordinate and harmonize regulation of the Canadian capital markets" through consensus policy decisions.[61] Chief among these usually-but-not-always harmonious policies is National Policy 62-202 – *Takeover Bids – Defensive Tactics*,[62] which gives regulatory embodiment to the view that shareholders deserve the right to make a fully informed decision on an offer.[63] While the regulators claim that "authorities appreciate that defensive tactics . . . may be taken by a board of directors of a target company in a genuine attempt to obtain a better bid," the National Policy 62-202 makes clear that "tactics that are likely to deny or limit severely the ability of the shareholders to respond to a take-over bid or a competing bid may result in action by the Canadian securities regulatory authorities."[64] As a result, Canadian regulators prefer speedy shareholder votes and auctions, and they

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58 *Id.*

59 *Id. See, e.g.*, Re KDR Industrials Ltd., 2015 ABASC 551 (Can.) (cease trade order for failure to file periodic audited and unaudited financial disclosures); Revocation Order, Texas South Energy Inc., 2014 BCSECCOM 250, ¶ 1 (Can.) (company was cease traded until it filed a prospectus regarding planned distributions to shareholders); Re Petaquilla Minerals Ltd., 2012 BCSECCOM 442, ¶¶ 40–41 (finding it in the public interest to cease trade a shareholder rights plan).

60 If you are confused, imagine a cross between the SEC and the American National Conference of Commissioners on Uniform State Laws—lots of recommendations, none of them binding, but most of them adopted by most states. The CSA, comprising only ten provinces and three territories in its membership, has a fairly good track record of creating uniform laws. *Cf.* Wildgoose Brown, *supra* note 53, at 305 (pointing out that there is significant variation in the application and enforcement of the CSA policy recommendation even after they are enacted by each member jurisdiction).

61 *Overview*, CANADIAN SECURITIES ADMINISTRATORS, http://www.securities-administrators.ca/aboutcsa.aspx?id=45 (last visited Nov. 9, 2014).

62 *See, e.g.*, *Notice of National Policy 62-202 and Recission of National Policy Statement No. 38 Take-Over Bids – Defensive Tactics* (in force as of Aug. 4, 1997), ONT. SEC. COMM'N, http://www.osc.gov.on.ca/en/SecuritiesLaw_pol_19970704_62-202_fnp.jsp.

63 *Id.*

64 *Id.*

have not hesitated to intervene in takeovers to achieve those goals.[65] Furthermore, the Canadian Supreme Court readily defers to the judgments of the Securities Commissions and has asserted that the various provincial enactments are "clearly intended" to grant Commissions "a very wide discretion," leaving it up to them "to determine whether and how to intervene in a particular case."[66]

To be sure, there is no such thing as a permanent shareholder rights plan in Canada. They are temporary and are usually cease traded[67] within forty-two to fifty days of adoption without shareholder approval.[68] As we will see, however, prior to the adoption of Canada's new amendments, shareholder adoption of a poison pill is no guarantee of a its continued existence either.

1. The Fiduciary Duties of Canadian Corporate Boards

Before going any further, we must briefly sketch the fiduciary duties of corporate boards in Canada which underlie all the cases that follow. The Canadian Supreme Court holds that in exercising their fiduciary duty of care, directors must "act in the best interests of the corporation," which

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65 *See* Canadian Securities Administrators, *Request for Comments on Proposed National Instrument 62-105 Security Holder Rights Plans, Proposed Companion Policy 62-105CP, and Proposed Consequential Amendments,* [2013] 36 OSCB 2643, 2646–47 [hereinafter *Proposed NI 62-105 Security Holder Rights Plans*], http:// www.osc.gov.on.ca/en/SecuritiesLaw_ni_20130314_62-105_security-holder-rights-plan.htm.

66 Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission), [2001] 2 S.C.R. 132, ¶ 39. Note as well that where American courts have *Chevron* deference (Chevron U.S.A. Inc. v. NRDC, 467 U.S. 837 (1984)) for administrative statutory interpretations and the *Universal Camera* "substantial evidence" (Citizens to Pres. Overton Park, Inc. v. Volpe, 401 U.S. 402 (1971)) and "hard look" (Motor Vehicle Mfrs. Ass'n of the U.S., Inc. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29 (1983)) standards of review for agency fact finding. Similarly, Canadian courts have *Dunsmuir* deference to both agency interpretations and fact. Dunsmuir v. New Brunswick, 2008 SCC 9, [2008] 1 SCR 190, ¶¶ 50–56 (Can.). Recently in *McLean v. BCSC*, the Canadian Supreme Court asserted that *Dunsmuir* deference is to be afforded to securities commissions, McLean v. British Columbia (Securities Commission), 2013 SCC 67, ¶ 21 (reversing a lower court judgment and restoring the Commission's order and its construction of § 161(6)(d) of the Securities Act, RSBC 1996, c 418) (Can.)).

67 Meaning shareholders of the target corporation would be prohibited from obtaining more free or discounted shares under the terms of the shareholder rights plan.

68 CHRISTOPHER M. BRUNER, CORPORATE GOVERNANCE IN THE COMMON-LAW WORLD 87 (2013). *Cf.* Drew Hasselback & Barbara Shecter, *Regulators in Quebec, rest of Canada break logjam on poison-pill reform*, FIN. POST, Sept. 11, 2014, http://business.financialpost.com/2014/09/11/regulators-in-quebec-rest-of-canada-break-logjam-on-poison-pill-reform/?__federated=1 (saying fifty to eighty days is the normal period before cease trading). Additionally, while most shareholder rights plans end or are cease traded prior to this point, Sec. 636(a) of the Toronto Stock Exchange Manual requires that a plan must be ratified by shareholders within six months of adoption. *See TSX Manual*, TORONTO STOCK EXCHANGE, http://tmx.complinet.com/en/tsx_manual.html (last visited Nov. 11, 2014) (select "Part VI. Changes in Capital Structure of Listed Issuers").

generally means the maximization of value of the corporation.[69] The Canadian Supreme Court further instructed in *BCE Inc. v. 1976 Debentureholders* "that in determining whether [directors] are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, *inter alia*, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment."[70] If anything, this holding seems to say that corporate boards can consider a wide range of interests in deciding whether to implement or rescind a shareholder rights plan in the face of a hostile takeover, and, at the very least, management should have some discretion to consider the short *and* long-term interests of the shareholders.

To be sure, the securities commissions have taken the position that if a board is to use a shareholder rights plan, it may only do so to the extent that "the rights plan . . . facilitat[es] an auction, encourag[es] competing bids or otherwise maximiz[es] shareholder value."[71] Of course, the commissions read this policy to mean that once a rights plan is "unlikely to achieve any further benefits for shareholders" *according to the commission*, then the commission will cease trade the plan.[72]

2. Criteria for Regulatory Intervention to Override Corporate Boards That Adopt Takeover Defenses

Cease trading is especially likely when a board adopts a poison pill in the face of a hostile takeover without conducting a shareholder vote, but there are multiple factors that the commissions consider in making their determinations.[73] The factors securities commissions consider in deciding whether to cease trade (effectively equivalent to rescindment or redemption in American parlance) poison pills were enunciated in *Royal Host*, a joint decision by the Ontario, Alberta, and British Columbia Securities Commissions.[74] The commissions appreciated the difficulty of balancing the objective of National Instrument 62-203 to let shareholders decide whether to accept an offer and allowing management to act according to its perception of its fiduciary duty.[75] Since such balancing is highly fact dependent, the commissions offered a nonexclusive list of factors to consider, including:

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69 People's Department Stores Inc. v. Wise, [2004] 3 R.C.S. 461, ¶ 42 (Can.).

70 BCE Inc. v. 1976 Debentureholders, [2008] 3 R.C.S. 560, ¶¶ 80–81 (Can.) (interpreting director duties under the Canada Business Corporations Act, R.S.C. 1985, c C-44, s 122(1) (Can.)).

71 Re Baffinland Iron Mines Corp., [2010] 33 OSCB 11385, ¶ 26 (Can.) (emphasis added).

72 *Id.* ¶ 26 (Can.).

73 Re Canadian Jorex Ltd and Mannville Oil & Gas Ltd., [1992] 15 OSCB 257, 267 (Can.) (applying *Royal Host* factors). *See also* Lac Minerals Ltd. and Royal Oak Mines, [1994] 17 OSCB 4963 (Can.).

74 Re Royal Host Real Estate Investment Trust, [1999] 22 OSCB 7819, ¶ 68 (Can.).

75 *Id.*

whether shareholder pre-approval was obtained; when the plan was adopted; the number of potential offerors and what steps, if any, the target is taking to seek more and their likelihood of success; and "the nature of the bid, including whether it is coercive or unfair to the shareholders of the target company."[76]

In applying the *Royal Host* factors, the Ontario Securities Commission has frequently reiterated that even if shareholders approve a pill:

> [A] company's board of directors is not permitted to maintain a shareholders' rights plan indefinitely in order to prevent a bid's proceeding, but may do so as long as the board is actively seeking alternatives and if there is a real and substantial possibility that the board can increase shareholder choice and maximize shareholder value.[77]

This policy ostensibly aims to put shareholders first but it disadvantages the target's board; notice that the "real and substantial possibility" language allows the commission free reign to intervene and second guess the management's business judgment about what would be best for the value of the company and the shareholders short *and* long-term interests. Prior to the adoption of the new regulations, this allowed commissions to second guess management's efforts to maximize shareholder value and sometimes even the wishes of shareholders.

B. Canadian Securities Regulators Go on a Public Interest Power Spree

The stage is now set for a conflict that throws the Canadian system of takeover regulation into a tailspin. On one side, *1976 Debentureholders*' says that a corporate directors' fiduciary duties must embrace not only the interest of the shareholders but also those of other stakeholders including employees, bond holders, and the community—in other words consider long-term interests. On the other side, up until the adoption of this year's amendments, the Canadian Securities regulators maintained that corporate boards must focus only on shareholder wealth maximization, and regulatory decisions demonstrated that this wealth maximization was paramount even if it was detrimental of long-term interests and stakeholders.

Consider *1976 Debentureholders* seemed to allow for corporate boards to wait out a hostile takeover if they believed the company could provide more value to shareholders (and other stakeholders) long-term as an independent entity, *even though* the waiting game was not in the short-term in-

[76] *Id.* ¶ 58.

[77] *See* Re Chapters Inc. and Trilogy Retail Enterprises L.P., [2001] 24 OSCB 1657, 1659 (citing Re MDC Corporation and Regal Greetings & Gifts Inc., [1994] 17 OSCB 4971), http://www.osc.gov.on.ca/en/Proceedings_rad_20010316_chap_312.htm (Can.).

terests of the shareholders. The securities commissions went through the motions of balancing these considerations, frequently opining "the challenge we face is finding the appropriate balance between permitting the directors to fulfill their duty to maximize shareholder value in the manner they see fit and protecting the right of the shareholders to decide whether to tender their shares to the bid."[78] Nevertheless, regulators were only willing to wait forty to fifty-five days before cease trading a shareholder rights plan even if the board of directors had legitimate reasons for delaying or defeating a takeover (i.e., better prospects of long-term returns for shareholders or).[79] Even if the target's shareholders voted to approve of a poison pill, which is the clearest possible indication shareholders do not want to seek short-term gains, the commission still cease traded the pills. The commissions were second guessing shareholder decisions about what was in their own best interest (both in the long and short term).[80]

There were multiple instances where securities commissions dispensed with shareholder-approved poison pills. For instance, the Alberta Securities Commission (ASC) second guessed shareholders facing a hostile takeover in *1478860 Alberta Ltd. v. Canadian Hydro Developers ("Canadian Hydro")*.[81] A year prior to the uninvited takeover offer, 72% of Canadian Hydro's shareholders had voted to adopt a poison pill.[82] When the acquirer sought to cease trade Canadian Hydro's pill, Canadian Hydro's board pointed out that it was actively pursuing alternative bidders and that the bid was "inadequate" and "opportunistic."[83] Applying the *Royal Host* factors,[84] the ASC initially allowed Canadian Hydro's pill to remain in place and then inexplicably reversed itself sixty days later. By cease-trading the Canadian Hydro's shareholder rights plan the ASC essentially told the board of Cana-

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78 Re Royal Host Real Estate Investment Trust, [1999] 22 OSCB 7819, ¶ 68 (Can.).

79 *See, e.g.*, Re Baffinland Iron Mines Corp., [2010] 33 OSCB 11385, ¶ 26 (Can.).

80 The American approach could not be more different. The Delaware Supreme Court has flatly rejected this kind of searching review "under *Unocal* . . . because it would involve the court in substituting its judgment for what Is a 'better' deal for that of a corporation's board of directors." Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1153 (Del. 1989).

81 *See* Re 1478860 Alberta Ltd., 2009 ABASC 448 (Can.).

82 *Id.* ¶¶ 16, 31.

83 *Id.* ¶ 32.

84 As a reminder, these include:

> *[W]hether shareholder approval of the rights plan was obtained; when the plan was adopted; whether there is broad shareholder support for the continued operation of the plan*; the size and complexity of the target company; the other defensive tactics, if any, implemented by the target company; the number of potential, viable offerors; *the steps taken by the target company to find an alternative bid or transaction that would be better for shareholders*; the likelihood that, if given further time, the target company will be able to find a better bid or transaction; the nature of the bid, including whether it is coercive or unfair to the shareholders of the target company; the length of time since the bid was announced and made; the likelihood that the bid will not be extended if the rights plan is not terminated.

Royal Host Real Estate Investment Trust, [1999] 22 OSCB 7819, ¶ 58 (emphasis added) (Can.).

dian Hydro that using the tools the shareholders provided was somehow a violation of fiduciary duty despite the fact that *1976 Debentureholders* broader conception of fiduciary duty should have allowed the board to look to long-term shareholder wealth maximization.[85]

Then, without warning, the ASC and Ontario Securities Commission (OSC) seemed to reverse course by deciding cases whose outcomes could only be explained if the ASC and OSC were allowing corporate directors to fulfill their fiduciary duties as conceived in *1976 Debentureholders*. First, in *Re Pulse Data Inc.*, the ASC applied the *Royal Host* factors and allowed the target corporation to fend off an unsolicited takeover bid with a poison pill because the board sought and obtained the informed approval from 98% of shareholders and even though there were not "imminent" alternative bidders on the horizon.[86] Subsequently, in *Re Neo Material Technologies Inc,* 81% of a target corporation's shareholders approved a poison pill in the face of an open offer by a hostile acquirer and the OSC upheld the pill.[87] It opined that shareholder approval of a poison pill should indicate the pill is in "the *bona fide* interest of a target's shareholders"[88] and that "shareholder rights plans may be adopted for the *broader purpose of protecting the long-term interests of the shareholders*, where, in the directors' reasonable business judgment, the implementation of a rights plan would be in the best interests of the corporation."[89] It appeared as though the ASC and OSC were allowing corporate directors to just say no to hostile takeovers, right in line with Canadian Supreme Court precedent regarding long-term interests.

The doctrinal harmony was not to last. In *Lions Gate Entertainment Corp.,* a majority of the British Columbia Securities Commission ("BCSC") cease traded a rights plan recently approved by an informed majority of Lions Gate shareholders because the pill was not in the public interest.[90] Then the OSC essentially reversed its own holding in *Neo* stating that the target board's views on what was in the best interests of the company was merely a "secondary consideration," which the Canadian corporate law community into angst and confusion over whether boards could consider long-term interests without being second-guessed by regulators acting at the behest of a minority of shareholders who preferred to pursue short-term profit.

C. Old Habits Dying Hard: Regulators Forced to Propose New Solutions

Given the regulatory uncertainty, boards and their counsel became un-

[85] BCE Inc. v. 1976 Debentureholders, [2008] 3 R.C.S. 560, ¶¶ 80–81 (emphasis added) (Can.).
[86] Re Pulse Data Inc., 2007 ABASC 895, ¶ 102 (Can.).
[87] Re Neo Materials Technologies Inc., [2009] 32 OSCB 6941, ¶¶ 26–27 (Can.).
[88] *Id.* ¶ 69.
[89] *Id.* ¶ 112.
[90] Re Lions Gate Entertainment Corp, 2010 BCSECCOM 432, ¶ 47 (Can.).

sure of the extent to which they could rely on a poison pill to fend off hostile bidders even when they had secured shareholder approval. In addition, the economic climate had deteriorated, and there was tremendous sentiment—particularly in Quebec—that Canadian companies were too easily acquired and that boards had insufficient tools to fight back.[91] (Even as this Note goes to print the weakness of the Canadian dollar makes Canadian companies ripe for the picking.[92]) This was a view shared by some Canadian academics and Canadian law firms.[93] Some commentators opposed the role of regulators in takeovers because "by forcing companies to abandon takeover defenses after arbitrary periods of time, regulators leave shareholders vulnerable not just to hostile bidders but to unexpected turns of fate."[94]

The perceived problems with the system were so severe that Quebec was threatening to break ranks with the other provinces to prevent a "hollowing out of corporate Canada" by enacting measures to allow "just say no" defenses.[95] In other words, Quebec was unaccountably demanding to be more American, adopting the position that boards should have the ability to unilaterally maintain poison pills in the face of hostile takeovers. Even the former chairman of the Ontario Securities Commission, Mr. Edward Waitzer, was on board with the idea, arguing securities commissions should stop policing shareholder rights plans (and let courts decide) because the commissions "left Canadian firms largely helpless in the face of U.S. activist investors and hedge funds" and because "nobody really knows what the law is now."[96] Perhaps the strength of the reaction can be partially explained by an overreaction to dashed expectations that *Neo* and Pulse's

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[91] *See e.g.*, Nicolas Van Praet, *'Takeovers are Coming': Some of Quebec's Biggest Companies Seem Vulnerable to Foreign Bids*, FIN. POST (Nov. 27, 2012, 9:26 PM), http://business.financialpost.com/2012/11/27/takeovers-are-coming-some-of-quebecs-biggest-companies-vulnerable-to-foreign-bids/ (raving that "half of Quebec's 50 biggest publicly traded companies are vulnerable to foreign takeover attempts" and advocating for protectionist anti-takeover policies); Alexander Schmitt, *Why Are Activist Investors Drawn to Canada*, MONDAQ (May, 28, 2014), http://www.mondaq.com/canada/x/316674/Shareholders/Why+Are+Activist+Investors+Drawn+To+Canada.

[92] Blake's Mergers & Acquisitions Group, *Legal Trends 2016: Mergers & Acquisitions*, MONDAQ, Apr. 4, 2016, Factiva, Doc. No., BBPUB00020160404ec44000e6 (forecasting that foreign acquirers would be able to "scoop up Canadian assets at bargain prices").

[93] *See* Barbara Shecter, *Poison pill creator notes differences in Canada-U.S. style*, FIN. POST, Oct. 9, 2013, at FP2 (quoting M&A panelists remarks that directors should have more leeway in their ability to resist a deal, rather than be driven solely by share price premia, and that there is a "serious vacuum" in the rules surrounding takeovers in Canada).

[94] Adrian Myers, *Regulators should get out of takeovers*, GLOBE & MAIL (Toronto Can.), June 12, 2014, at B6, 2014 WLNR 15831126.

[95] Jeff Gray, *Quebec Looks at Going it Alone on Poison Pills*, GLOBE & MAIL (Toronto Can.), Mar. 15, 2013, at B3, 2013 WLNR 6465284.

[96] Jeff Gray, *Putting the Poison Back in the Pill*, GLOBE & MAIL (Toronto Can.), Sept. 7, 2011, at B8, 2011 WLNR 17654567.

board-friendly holdings were here to stay,[97] but regardless of the cause, Canadian regulators were taking fire from all sides.

To address all these problems, including the massive inefficiencies created by chronic uncertainty and Quebec's proposal to import the American "just say no" rule into its takeover regulations,[98] the Canadian Securities Administrators drafted amendments to National Instruments 62-203 and 62-105, which respectively regulate takeover bidding and the use of shareholder rights plans (SRPs). These draft amendments were altered slightly following notice and comment, and they received ministerial approval on May 5, 2016.[99] There are three key changes.

First, the deposit period is increased from 35 to 105 days unless the target board waives the requirement or announces an alternative transaction.[100] Second, the offeror (acquirer, i.e., bidder) cannot take up deposited securities in a take-over bid unless "more than 50% of the outstanding securities of the class that are subject to the bid, excluding securities beneficially owned, or over which control or direction is exercised, by the offeror or by any person acting jointly or in concert with the offeror, have been deposited under the bid."[101] Third, once these conditions are met, the offeror must give shareholders who have not yet tendered their shares an additional ten

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[97] *See* James C. Davies, *Toward a Theory of Revolution*, 27 AM. SOC. REV. 5, 6–7 (1962). Davies posits that revolutions occur when there is a period of positive development where needs (economic, social, or political) are satisfied at or beyond expectations, followed by a short period of sharp reversal where community needs and expectations continue to grow as before but are increasingly unfulfilled. *Id.* at 6. In our case, *Neo* and *Pulse* might have built up expectations that corporate boards might have the means to fight off a burgeoning wave of M&A activity in Canada, only to have those expectations come crashing down again. *See* Jeff Gray, *Why targets could get harder to swallow*, GLOBE & MAIL (Toronto Can.), Feb. 17, 2010, at B8 (discussing *Neo Materials* and whether it could signal a move toward allowing boards more discretion in adopting poison pills). Dashed expectations may well have forced regulatory action.

[98] In other words, Quebec was threatening to enact a regulation that gave board's total discretion to adopt or rescind a poison pill without shareholder approval. *See generally Consultation Paper: An Alternative Approach to Securities Regulators' Intervention in Defensive Tactics*, AUTORITÉ DES MARCHÉS FINANCIERS (Mar. 14, 2013), http://www.lautorite.qc.ca/files/pdf/consultations/juin-2013/2013mars14-avis-amf-62-105-cons-publ-en.pdf (weighing in against the ability of regulators to "cease trade" poison pills that had garnered majority shareholder approval). Of course, shareholders desiring to tender their shares could always vote to replace the anti-takeover board members in a proxy fight, but that is an expensive and time consuming option.

[99] Notice of Ministerial Approval of Amendments to Take-Over Bid Regime and Early Warning System, 39 OSCB 4187, 4187 (May 5, 2016), https://www.osc.gov.on.ca/documents/en/Securities-Category6/ni_20160505_62-104_amd-take-over-bids.pdf.

[100] Changes to *National Policy 62-203*, Take-Over Bids and Issuer Bids § 2.10, 39 OSCB 4275, 4275 (May 5, 2016); *see generally CSA Notice of Amendments to Take-Over Bid Regime* – Amendments to *Multilateral Instrument 62-104 Take-Over Bids and Issuer Bids* and Changes to *National Policy 62-203 Take-Over Bids and Issuer Bids* and Consequential Amendments, 39 OSCB (Supp-1) (Feb. 25, 2016), http://www.osc.gov.on.ca/documents/en/Securities-Category6/csa_20160225_62-104_amd-take-over-bids.pdf.

[101] National Instrument 62-104, *Takeover Bids and Issuer Bids* § 2.29.1, 39 OSCB 4228, 4242 (May 5, 2016), http://www.osc.gov.on.ca/documents/en/Securities-OSCB/20160505_oscb_3918_toc.pdf.

days to do so.[102] Of course, these new take-over regulations only apply "where the securities subject to the offer to acquire, together with the offeror's securities, constitute in the aggregate 20% or more of the outstanding securities" of the target.[103]

One suggested reform that did not make it into the final regulations provided that a non-exempt[104] "bidder and its joint actors are excluded from the shareholder vote required to adopt, maintain, amend or terminate a Rights Plan."[105] This would have meant that a bidder would be unable to launch a proxy fight to gain control of the board or rescind a pill. Despite this omission, the three key changes are sufficient to bring clarity and balance to the Canadian hostile takeover regime.

Indeed, the 105-day deposit period means negotiating power shifts towards the target since bidders must secure financing for the entire period, leaving the target increased opportunity to pursue alternative friendly transactions, decreasing the likelihood hostile takeovers will succeed,[106] and in the energy sector this extended deposit period is particularly target-friendly since it means that the acquirer will have to worry about exposure to drops in commodity prices for a much longer period of time.[107]

More generally, the amendments provide for shareholder self-determination while giving boards more time to negotiate and largely eliminating the uncertainty caused by the arbitrary exercise of regulatory public interest jurisdiction after forty-five to seventy days depending on regulatory whim.[108] Unless the target "engages in conduct that undermines the principles underlying the Proposed [now final] Rule or there is a public interest rationale for the intervention not contemplated" by the Rules, securities regulators will in all likelihood not reach the question of whether a pill must

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[102] *Id.* § 2.31.1, 39 OSCB 4228, 4243.

[103] *Id.* § 1.1, 39 OSCB 4228, 4230.

[104] Exempt bids are for, among other things, friendly transactions where the board consents to the takeover; non-exempt bids are the kind that must be made to all shareholders, like hostile takeover bids. *See Securities Act, Multilateral Instrument 62-104* Take-Over Bids and Issuer Bids, § 4.

[105] *See* Canadian Securities Administrators, *Proposed NI 62-105 Security Holder Rights Plans, supra* note 65, at 2653.

[106] Jason A. Saltzman, Canadian Securities Administrators Amend Take-Over Bid Rules, Mondaq, Apr. 15, 2016, Factiva, Doc. No., BBPUB00020160415ec4f000bu.

[107] New Takeover Rules Limiting Poison Pills Will Make it Harder to Bring Hostile Bids, NATIONAL POST: LEGAL POST (Mar. 1, 2016, 3:03 PM), http://business.financialpost.com/legal-post/new-takeover-rules-limiting-poison-pills-will-make-it-harder-to-bring-hostile-bids. Companies have already started to take advantage of their newfound negotiating leverage. *See, e.g.*, Dow Jones Institutional News, Press Release: UrtheCast Announces Adoption of Shareholder Rights Plan, Apr. 6, 2016, Factiva, Doc. No., DJDN000020160406ec46001au; ENP Newswire, Bear Creek Mining Board Approves Adoption of Shareholder Rights Plan, Apr. 25, 2016, Factiva, Doc. No., ENPNEW0020160425ec4p000du.

[108] Sean Vanderpol & Edward Waitzer, *Regulators Restrain a "Public Interest" Push on Poison Pills*, FP COMMENT (Mar. 8, 2016, 4:14 PM), http://business.financialpost.com/fp-comment/regulators-restrain-a-public-interest-push-on-poison-pills.

go since most bidders will either reach agreement with the target in 105 days or abandon their takeover attempt (or not even make the attempt in the first place).[109] Still, some practitioners add that there may be circumstances where regulators might allow a poison pill to remain past 105 days if a clear majority of shareholders voted to approve the plan while the bid was pending or perhaps where there is an eleventh-hour revelation justifying giving the target more time.[110] In other words, the new regulations reemphasize the notion that Canadian law gives corporate boards the ability to "just say slow" rather than "just say no," giving them leeway to maximize shareholder value without stymieing the market for corporate control.[111]

This resolves the longstanding discrepancy between the logic of the Canadian Supreme Court in *1976 Debentureholders*, which broadly defined the fiduciary duties of directors (allowing them to consider long-term interests and affording a modicum of deference to their judgment), and the official policies of the provincial securities regulators which, up until now, would essentially second guess any attempt to prevent shareholders from voting on a takeover bid. Under the new rules, the *Neo*, *Pulse*, *Lions Gate*, and *Baffinland* cases would never have occurred because directors would have had 105 days to negotiate a deal or seek renewal of the pill from shareholders—no need to litigate abstruse questions of fiduciary duty.

From the perspective of the shareholder-primacy camp, these proposed rules are what they have always wanted, and roughly approximate what Justice Strine suggested should be a compromise position for the American system. The proposed rules involve a limited poison pill subject to shareholder approval and allow for the target board to wage a proxy fight to "convince stockholders that they are better off if the bid is rejected."[112] By the same token, Bainbridge and Strine would probably both suffer migraines at the thought that shareholders could vote at any time to rescind a pill, but that is the cost of compromise. While one might argue that this makes minority shareholders subject to the whims of an entrenched board, this is only true until the next annual board election or the expiry of the deposit period.

There was one missed opportunity, however. The final amendments did not follow through on proposed amendments' efforts to combat "empty

[109] Canadian Securities Administrators, *Proposed NI 62-105 Security Holder Rights Plans, supra* note 65, at 2650.

[110] Drew Hasselback*, New Takeover Rules Limiting Poison Pills Will Make it Harder to Bring Hostile Bids*, NATIONAL POST: LEGAL POST (Mar. 1, 2016, 3:03 PM), http://business.financialpost.com/legal-post/new-takeover-rules-limiting-poison-pills-will-make-it-harder-to-bring-hostile-bids.

[111] Ruben Zaramian, Maximizing Shareholder Value Through Process: Canada's New Take-Over Bid Rules, Mondaq, Mar. 9, 2016, Factiva, Doc. No., BBPUB00020160309ec39000y1.

[112] *See* Strine, *supra* note 15, at 459–61.

voting" tactics that had so vexed Hu and Black.[113] This is arguably a serious problem in Canada. For instance, TELUS Corporation (a giant Canadian telecom firm) was thwarted in its efforts to convert its non-voting shares into voting shares because a New York hedge fund bought up a combination of shares and derivatives such that it could block the conversion and profit as the non-voting share price fell while not holding any actual economic interest in TELUS.[114] The proposed amendments included provisions counting derivatives and "equity equivalent derivatives" for both mandatory voting and Early Warning Reporting thresholds, but the final rules did not include these changes.[115]

Nevertheless, Canada's proposed amendments allow boards to adopt poison pills and retain them for a useful period of time such that negotiating power is increased while shareholders retain their right to vote on a takeover transaction at auction should they so desire.

IV. THE AMERICAN SYSTEM

A. The American Legal Apparatus: Delaware Reigns Supreme

State statutes and judicially crafted rules align to make the American system of takeover regulation so board-centric as to effectively deny shareholders the right to vote on takeover transactions without board approval. This is because the American system of takeover regulation is informed primarily by state—Delaware—corporate law and SEC regulations. Directors' duties of care are defined by state statute, but unlike in Canada, there is no regulator with wide-ranging "public interest jurisdiction" to step in and enforce that duty of care, let alone bring entrenched or corrupt management to heel on behalf of beleaguered shareholders. Instead, shareholders must file a formal suit in court, which almost always defers to manage-

[113] Canadian Securities Administrators, ONT. SEC. COMM'N, *CSA Notice 62-307: Update on Proposed Amendments to Multilateral Instrument 62-104* Take-Over Bids and Issuer Bids, *National Instrument 62-103* Early Warning System and Related Take-Over Bid and Insider Reporting Issues *and National Policy 62-203* Take-Over Bids and Issuer Bids (Oct. 10, 2013), http://www.osc.gov.on.ca/documents/en/Securities-Category6/csa_20141010_62-307_proposed-admendments-multilateral-instrument.pdf.

[114] *See* Letter from Monique Mercier, TELUS Chief Legal Officer to the Ontario Securities Commission and *Autoritê des marchés financiers* regarding CSA Request for Comment on Proposed National Instrument 62-203 (July 7, 2013), http://www.osc.gov.on.ca/documents/en/Securities-Category6-Comments/com_20130702_62-203_teluscorp.pdf. *Cf.* Letter from James Trotter, Council of Institutional Investors, to the OSC and AMF regarding CSA Request for Comment on Proposed National Instrument 62-203 (July 11, 2013), http://www.osc.gov.on.ca/documents/en/Securities-Category6-Comments/com_20130711_62-203_counselofii.pdf (claiming that empty voting poses no problem at all and that the CSA would be ill-advised to require the disclosure of derivatives).

[115] McCarthy Tetrault LLP, *Canada's Early Warning Rules Get Tougher in May*, MONDAQ, Mar. 9, 2016, Factiva, Doc. No. BBPUB00020160309ec39000vv.

ment under the "business judgment rule."[116] Hence, state courts are not nearly as aggressive as Canada's regulators have been.

When the Delaware Chancery Courts confront a board's decision to resist a hostile takeover, the business judgment rule remains a nearly impenetrable defense. The business judgment rule forms the basis of the *Unocal* test which shields nearly any defensive tactic, including poison pills.[117] To prevent the invalidation of a defensive measure, the board of directors need only demonstrate that it "had reasonable grounds for believing that a danger to corporate policy and effectiveness existed" and that its "defensive response was reasonable [and proportionate] in relation to the threat posed."[118] This deferential standard has a wrinkle in the form of *Blasius Industries, Inc. v. Atlas Corp.,* where, "under very unusual facts" the Delaware Supreme Court "held that the board of directors must provide a 'compelling justification' for its actions where the board acted 'for the primary purpose of interfering with the effectiveness of a stockholder vote.'"[119] However, *Blasius* has been subsequently interpreted to require that directors have the sole, specific intent to deprive shareholders of the right to vote on a takeover bid, which explains why nobody has successfully used *Blasius* to get a Delaware court to force the rescission of a shareholder rights plan.[120] Hence, Delaware courts and a supermajority of other state courts apply the *Unocal* standard, meaning poison pills can remain active indefinitely without any need for shareholder approval until the next annual board election.

Board entrenchment is made worse by the default allowance of classified boards under Delaware law, which makes it impossible for an acquirer to gain control of the board without going through two years of proxy fights.[121] When *Unocal* and staggered boards are considered together, they

[116] The business judgment rule defers to the "managerial prerogatives" of directors by creating a "presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled on grounds not relevant here by* Brehm v. Eisner, 746 A.2d 244, 255 (Del. 2000).

[117] Unitrin, Inc. v. American Gen. Corp., 651 A.2d 1361, 1373 (Del. 1993) (citing Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985)).

[118] *Id.*

[119] Third Point LLC v. Ruprecht, No. CIV.A. 9469-VCP, 2014 WL 1922029, at *15 (Del. Ch. May 2, 2014) (quoting Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch.1988)). The reader may be interested to know that *Third Point* involved the takeover of the venerable auction house Sotheby's. For additional analysis, see Michael O'Bryan & Enrico Granata, *Delaware Court Upholds Poison Pill in Response to Activist Accumulations*, 25 WESTLAW J. M&A 1 (July 25, 2014) (discussing a two-tier trigger shareholder rights plan and the limits of board discretion under *Unocal*).

[120] *See* Michal Barzuza, *The State of State Antitakeover Law*, 95 VA. L. REV. 1973, 2015–17 (2009). Barzuza indicates that Michigan, Nevada, New York, and Massachusetts have used *Blasius* or some other enhanced fiduciary standard when striking down the more extreme versions of poison pills (i.e. "dead hand" pills, which can only be rescinded by those directors who implemented them). *Id.*

[121] *See* DGCL, DEL. CODE ANN. tit. 8, § 141(d) (West 2014) (allowing boards of up to three classes). The effect of this provision of the DGCL is to elect the board like the United States Senate. Only a few

have the effect of allowing American boards to unilaterally implement poison pills in the face of a takeover, and shareholders have no recourse absent a proxy fight.[122] Unfortunately, the proxy fight itself is also a relatively ineffective route for shareholders to use to attempt to rescind a pill since the target board has several ways to tilt the process in its favor including the ability to spend corporate funds on winning the board election. A prospective acquirer has no recourse in court against an unfairly rigged proxy fight unless success is "not realistically attainable."[123] This is tantamount to no recourse at all.

Taken together, the American policies make *hostile* takeovers practically impossible, reducing shareholder value.[124] Indeed, the burdens of completing a hostile takeover are so high that no hostile bidder has succeeded in a hostile takeover of a company with a staggered board and an active shareholder rights plan since at least 1996![125] Plus, the litigation costs involved in a hostile takeover and the ensuing proxy fight make the American system of takeovers very expensive relative to its peer nations.[126] This

seats are up at any one time. Also like the U.S. Senate, under the DGCL, there can be a maximum of three classes of directors, so each class must be up for election once in three years. From the perspective of an acquirer, this is problematic because it means that he must win board elections two years in a row to gain control of the board and rescind the poison pill. Also, DGCL, DEL. CODE ANN. tit. 8, § 141(k)(1) (West 2014) sets as a default rule that unless the certificate of incorporation provides otherwise, directors on classified boards are removable only "for cause." Under the Canada Business Corporations Act, R.S.C. 1985, c C-44 ("CBCA"), sec 109(1) (Can.), "the shareholders of a corporation may by ordinary resolution at a special meeting remove any director or directors from office." Since CBCA § 2 defines "ordinary resolution" as a majority vote, all directors of businesses incorporated under the CBCA are subject to removal without cause by majority vote at any time. The total opposite of the Delaware default rules for Articles of Incorporation.

[122] In states that follow *Unocal*, shareholders have been unable to use bylaw amendments to forbid board adoptions of poison pills, largely because boards can unilaterally amend bylaws. *See* MODEL BUS. CORP. ACT, § 10.05 (AM. BAR ASS'N 2006); DEL. CODE ANN. tit. 8, § 109(b) (West 2014). Oklahoma was the temporary exception. In 1999 its Supreme Court held that "under Oklahoma law there is no exclusive authority granted boards of directors to create and implement shareholder rights plans" against the wishes of a majority of shareholders, but shareholders rights to "propose bylaws which restrict board implementation of shareholder rights plans" exist only if "the certificate of incorporation does not provide otherwise." Int'l Bhd. of Teamsters Gen. Fund v. Fleming Companies, Inc., P.2d 907, 908 (Okla. 1999). Unfortunately for shareholder rights advocates, the effect of this holding was easily evaded because every subsequently incorporated entity need only include a charter provision denying shareholders the right to enact pill-defeating bylaws.

[123] Selectica, Inc. v. Versata Enters., Inc., 5 A.3d 586, 601 (Del. 2010). *See also* Paul H. Edelman & Randall S. Thomas, *Selectica Resets the Trigger on the Poison Pill: Where Should the Delaware Courts Go Next?*, 87 IND. L.J. 1087 (2012).

[124] *See* Comment & Schwert, *supra* note 40, at 43; Bebchuk & Cohen, *supra* note 39, at 415–17.

[125] *See* R. FRANKLIN BALOTTI & JESSIE A. FINKELSTEIN, DEL. L. OF CORP. & BUS. ORG. § 4.6 (R. Franklin Balotti & Jesse A. Finkelstein eds. 2006); Bebchuk & Cohen, *supra* note 39, at 413 (citing Lucian A. Bebchuk, *Why Firms Adopt Antitakeover Arrangements*, 152 U. PA. L. REV. 713–753 (2003)). This assumes that the corporation has three classes of directors on the board, the maximum allowable under Delaware corporate law. *See* DEL. CODE ANN. tit. 8, § 141(d) (2010).

[126] *See* Armour et al., *supra* note 8, at 1749 (comparing American and British leading M&A law

state of affairs has all the effects that the law and economics academics warn of, including decreased firm economic performance and persistently incompetent management.

B. Curbing American Excess

Adopting the Canadian rules would restore shareholder's ability to have a meaningful say on takeover transactions while maintaining a board's ability to resist coercive hostile takeovers indefinitely. Recall that the proposed Canadian rule would allow boards unilateral discretion to adopt an SRP for 105 days and potentially longer with shareholder approval. If adopted in the American context, the rule would have positive effect by re-empowering shareholders. Since shareholders need not control the board to rescind[127] (American for "cease trade") the poison pill, the acquirer can take up enough shares to make control all but certain in the next two elections.[128] A director faced with all but certain defeat in two years will probably see he is better served by a quick exit than remaining on the board of a company of which he is destined to lose—perhaps this might even make would-be holdouts more likely to work cooperatively with the acquirer in the first place.

In addition, even though America does not benefit from the Canadian rules that make classified boards removable at any time by majority vote,[129] an outright ban on classified boards might not be necessary for the Canadian 90-day rule to effectively allow for an acquirer to gain control of the board for most corporations. Institutional shareholders have taken significant strides using ordinary shareholder voting procedures to amend corporate charters and bylaws to eliminate classified boards in large companies, reducing the number of S&P 500 companies with classified boards from 303 to 126 between 1999 and 2012.[130] Fifty-two more of the S&P 500 de-

firms to reveal the American lawyers generated more than double the revenue of their British counterparts).

[127] This is American for "cease trade." The technical distinction is that when a board rescinds a pill, it usually must pay the shareholders some nominal consideration in exchange for them surrendering their rights to buy shares. WILLIAM J. CARNEY, MERGERS AND ACQUISITIONS: CASES AND MATERIALS 352 (3d ed. 2011). However, when a Securities Commissioner "cease trades" the pill, the warrants simply cannot be exercised—no consideration changes hands. If shareholders use the Canadian Rule to "rescind" a pill, it is likely that no consideration will be paid since the shareholders are essentially waiving their rights under the plan.

[128] This obviates the need to strain existing doctrine by treating a loss in a proxy contest as a referendum on the pill. *See* Lucian A. Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence and Policy*, 54 STAN. L. REV. 887, 944–49 (2002) (arguing that Delaware courts should interpret the "reasonableness" prong of the *Unocal* test such that a loss in a proxy contest should be sufficient grounds to rescind a pill over management's objections).

[129] *See* Canada Business Corporations Act, R.S.C. 1985, c C-44, secs 2, 109(1) (Can.) (providing that directors are removable by ordinary shareholder resolution which requires a mere majority vote).

[130] Lucian A. Bebchuk, Scot Hirst & June Rhee, *Towards the Declassification of S&P 500 Boards*, 3

classified their boards in 2013, and twenty-four further companies agreed in 2014 to use annual elections for all directors.[131] In light of these advancements, the shareholders in more American companies than ever would be able to use the Canadian rule exactly as designed—the tendering of shares would occur simultaneously with the change of control.

One of the criticisms leveled at the Canadian rule was that it would increase proxy fights and litigation surrounding them.[132] While this may be true, it cannot be said that American firms would suffer any net increase in their legal bills by eliminating an entire subject of litigation. Even if there is an increase in litigation over proxy fights, at worst, the only dollars spent will be those that have otherwise been dedicated toward attacking or defending the shareholder rights plan.[133] Plus, any attempts at thwarting voting during the proxy fight might actually breathe a little vitality into the *Blasius* standard, and boards might discover that any attempt to restrict the shareholder franchise will be met with far less deference than their former attempts to implement or retain poison pills.[134]

Adopting the Canadian rules would eliminate protracted court battles over the legality of various types of pills since they can be easily removed at the end of the deposit period—and if they cannot, it is only because the shareholders have said so. For instance, in *AirGas* it took sixteen months of trials and appeals for a Delaware Chancery court to determine that a poison pill could not be redeemed.[135] The Canadian rule likely would have allowed a sufficient number PeopleSoft shareholders to vote to rescind the PeopleSoft's pill and tender their shares without having to endure an eight-

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HARV. BUS. L. REV. 157, 165 (2013) (citing *Classified Boards Year Over Year*, SHARKREPELLENT, http://sharkrepellent.net (last visited Feb. 1, 2013)).

[131] *121 Companies Agreed to Move Towards Annual Elections*, HARV. SHAREHOLDER RTS. PROJ., http://srp.law.harvard.edu/companies-entering-into-agreements.shtml (last visited Feb. 17, 2015).

[132] *See* Barry Critchley, *Activism, Takeover Rules Can Co-Exist*, NAT'L POST, Nov. 14, 2014, at 2, 2014 WLNR 32018919.

[133] The nature of the Canadian regulation also begets efficiency and cost effectiveness. Implementing the 90-day brightline rule would require adjudicating the adequacy of adherence to an easily testable criterion, rather than nebulous musings on "public interest" or even "business judgment" standards. *See* Pierre Schlag, *Rules and Standards*, 33 UCLA L. REV. 379, 387–88 (1985) (arguing that brightline rules "reduce the cost of communicating" facilitating "communications and transactions"); Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557 (1992) (noting that rules are more efficient and appropriate for situations where the conduct governed occurs frequently, as it will with the 90-day rule).

[134] *See* Carmody v. Toll Bros., 723 A.2d 1180, 1186–87 (Del. Ch. 1998) (discussing permissible and impermissible ways corporate boards might attempt to interfere with proxy contests).

[135] Airgas, Inc. v. Air Products & Chemicals, Inc., No. CIV.A. 5817-CC, 2010 WL 3960599 (Del. Ch. Oct. 8, 2010), *rev'd*, 8 A.3d 1182, 1185 (Del. 2010); Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 57 (Del. Ch. 2011) (noting this was the most court time a poison pill case had received in Delaware history). *See generally* Steven M. Davidoff, *A Case Study: Air Products v. Airgas and the Value of Strategic Judicial Decision-Making*, 2012 COLUM. BUS. L. REV. 502, 547 (2012).

een-month slog to the finish line.[136] And the Canadian Rule would likely have allowed Circon shareholders to bypass a staggered board and poison pill to at least tender their shares to U.S. Surgical in 1996 rather than be forced to accept a deal for 17% less two years later.[137] In each of these cases, entrenched boards were holding out for unreasonably long periods of time while incurring substantial litigation and attorney fees. The Canadian Rule, with its simple 105-day limit, would do away with much of this deadweight.[138] Of course, if the pill remained at the end of the 105-day period, a judge (like the Canadian securities commission) would have to determine whether the pill should stay or go, but after the board has had such a long time to find alternative transactions it will be much easier to assess whether the board is acting to maximize shareholder value or merely to entrench and enrich itself.

The Canadian Rule also eliminates any possibility of "substantive coercion."[139] Since shares cannot be tendered to acquirer under the rule for 105 days, there is no risk shareholders will sell their shares lemming-like without exacting a control premium because the board has plenty of time to inform them of the facts and prevent an unjustified dash for the exits. By allowing corporate boards to adopt poison pills, the Canadian Rule also helps boards avoid the problem of divided economic and control rights in shares. Since the a poison pill can have triggering threshold[140] (i.e., 5% of all outstanding shares) at a level so low as to prevent an acquirer from gaining substantial control of the company, the pill can prevent an activist investor from gaining enough control to engage in arbitrage.[141]

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[136] *See* Paul R. La Monica, *Finally, Oracle to Buy PeopleSoft*, CNN/MONEY (Dec. 13, 2004, 12:53 PM), http://money.cnn.com/2004/12/13/technology/oracle_peoplesoft/; David Bank, *After 18-Month Battle, Oracle Finally Wins Over PeopleSoft*, WALL ST. J. (Dec. 14, 2004, 12:01 AM), http://www.wsj.com/articles/SB110293586982698273.

[137] *See* Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, *supra* note 42, at 1033; *U.S. Surgical's Offer for Circon Becomes Hostile*, N.Y. TIMES, Aug. 17, 1996, http://www.nytimes.com/1996/08/17/business/us-surgical-s-offer-for-circon-becomes-hostile.html.

[138] And if the shareholders felt like paying for a lengthier test of wills at the negotiating table, then they remain totally free to maintain the shareholder rights plan.

[139] *See* Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1153 n.17 (Del. 1990), *citing with approval to* Ronald J. Gilson & Reinier Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 BUS. LAW. 247, 267–68 (1989) (defining "substantive coercion" as "the risk that shareholders will mistakenly accept an underpriced offer because they disbelieve management's representations of intrinsic value").

[140] If an acquirer buys more shares after reaching this level of ownership in the company, then shareholders either receive shares or the rights to purchase shares (in accordance with the terms of the rights plan).

[141] Additionally, if the United States were to adopt the Canadian enhanced disclosure rules, that would have the added effect of thwarting arbitrageurs who exploit the ability to divide economic and control rights in shares. The United States does not currently require disclosure of these "hidden ownership" interests, but the new Rule in Proposed *National Instrument 62-103* would help eliminate this problem. *See* Michael C. Schouten, *The Case for Mandatory Ownership Disclosure*, 15 STAN. J.L. BUS. & FIN. 127 (2010) (arguing for disclosure regulations to prevent abuse of "hidden ownership" and "emp-

Given the foregoing, it seems it would be entirely beneficial for the United States or each of its states to adopt the new Canadian Rule regarding poison pills.

V. TAKEOVER REGULATION AND DEFENSES IN THE UNITED KINGDOM

The defining feature of the United Kingdom's system of takeover regulation is that it strongly favors acquirers and shareholders. This has led to concerns that the system does not give corporate boards sufficient leverage to maximize shareholder value. With minor changes, the Canadian proposed rules could be adopted in the United Kingdom to increase board leverage while maintaining shareholder primacy overall**.**

A. The British Public–Private Regulatory System

For historical reasons, the takeover regime of the United Kingdom, when compared with the United States and Canada, favors shareholders to a much greater degree.[142] This is mostly because it evolved out of the interwoven relationships of major financial institutions and institutional shareholders, which coalesced around the formation of the Takeover Panel.[143] Not surprisingly, given who developed the system, the United Kingdom has "very few legal sanctions to control the manner in which [companies] are bought, sold, and dismembered."[144]

Generally speaking, listed public companies are subject to the oversight of The Takeover Panel, a public-private hybrid regulatory board. In this respect, the United Kingdom is much closer to Canada than the United States because British courts defer almost completely to the Panel as the designated tribunal.[145] The Panel's activities, in turn, are governed by The

ty voting" interests); Jordan M. Barry, et al., *On Derivatives Markets and Social Welfare*, 99 VA. L. REV. 1103, 1156–59 (2013) (outlining the level of disclosure necessary to stop arbitrage). For a perspective on what levels of disclosure might be required to solve the hidden ownership problem throughout Europe, see Wolf-Georg Ringe, *Hedge Funds and Risk Decoupling: The Empty Voting Problem in the European Union*, 36 SEATTLE U. L. REV. 1027, 1087–99 (2013).

[142] *See* Armour et al., *supra* note 8, at 1767–77 (2007) (explaining that the relatively high level of institutional share ownership early on in the U.K. allowed such investors to create a system of self-regulation favoring their interests as shareholders and repel government attempts at regulation).

[143] *Id.*

[144] *See* NILUFER VON BISMARCK, CORPORATE ACQUISITIONS AND MERGERS IN THE UNITED KINGDOM ¶ 22 (2013).

[145] The High Court of Appeal observed that it could interfere with Takeover Panel decisions only "if there has been illegality (the panel has misdirected itself in law), irrationality (no reasonable panel could have reached such a decision) or procedural impropriety (failure by the panel to conform to the rules governing its own conduct or to basic rules of natural justice)." R v. Panel on Takeovers and Mergers ex p Datafin [1987] 1 QB 817, 822 (appeal taken from Eng.).

City Code on Takeover and Mergers, which it promulgates and enforces.

The Panel had been a completely private entity since its establishment in 1968, but Parliament clothed the Panel with *de jure* authority by statute in 2006, making it a privately administered public regulatory body—Panel members are either current or former practitioners and are selected by both the Panel and financial institutions.[146] Section 804 of the Companies Act gives The Panel the extraordinarily broad authority to "do anything that it considers necessary or expedient for the purposes of, or in connection with, its functions," including amending the Takeover Code at will.[147]

Practitioners have quipped the Panel's first rule is only "thou shalt do what thou ist told,"[148] but any comparison to the Canadian securities administrators would be inapt. Though the Panel may regulate in any manner it desires by fiat, the Panel's historical practice and current view is that it should not consider "wider questions of public interest" or exercise what Canadian regulators would call "public interest" jurisdiction.[149] The Panel confines itself to ensuring the orderly acquisition and sale of companies while preventing target shareholders from undue prejudice.[150]

The Panel's self-defined role is embodied and effectuated through The Takeover Code,[151] the animating principle of which is that all classes of the target company shareholders must receive equal treatment and adequate information to make an informed decision on the bid, and that the target's management must act in the best interests of the company and cannot deny shareholders the right to accept or reject a bid.[152] Most importantly for our

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[146] *See* The Companies Act, 2006, c. 46, § 763 (U.K.), Directive of the European Parliament and of the Council on takeover bids (2004/25/EC), and the implementing Council Regulation (EC) No. 139/2004; *Panel Membership*, THE TAKEOVER PANEL, http://www.thetakeoverpanel.org.uk/structure/panel-membership (last visited Nov. 7, 2014) (explaining that the panel comprises thirty-five members of which twenty are selected by the Panel and of which eleven are selected by major institutions like the British Bankers Association and the Association of Investment Companies).

[147] It should be noted that any of the Panel's rules can be waived at its discretion, but it will readily refuse waivers if any shareholders will be prejudiced, in accordance with General Principle 1 of the Code.

[148] MCCLURE NAISMITH, CHRISTOPHER J. STENNING, & ANDREW G. WILLIAMSON, *Securities Law in the U.K.*, *in* INTERNATIONAL SECURITIES LAW HANDBOOK 641 (Michael Best & Jean-Luc Soulier eds., 3d ed. 2010). There is substantial truth to this statement since all persons and entities under the jurisdiction of the Takeover Panel and the Takeover Code must comply with the Code in both letter and spirit, even in situations the code does not expressly cover. *See* VON BISMARCK, *supra* note 144, ¶ 652 (2013).

[149] *See About the Panel*, THE TAKEOVER PANEL, http://www.thetakeoverpanel.org.uk/structure (last visited Nov. 7, 2014).

[150] *Id.*

[151] THE PANEL ON TAKEOVERS AND MERGERS, THE TAKEOVER CODE (2013) [hereinafter TAKEOVER CODE], http://www.thetakeoverpanel.org.uk (follow "Download Code as PDF" hyperlink).

[152] *See* NAISMITH, *supra* 148, at 641. Additionally, the Panel forbids efforts to create "false markets . . . in the securities of the offeree company, of the offeror company or any other company concerned by the bid" to artificially cause a rise or fall in share prices. THE TAKEOVER CODE, Gen. Princ. 4. This

purposes, Rule 21.1 of the Takeover Code flatly forbids defensive measures—like poison pills—"during the course of an offer, or even before the date of the offer if the board of the [target] has reason to believe that a bona fide offer might be imminent, without the approval of the shareholders in general meeting."[153]

Rule 25 requires the target board to send a circular to its shareholders containing its views on "the offer and the [acquirer]'s plans for the company and its employees" (along with impartial, independently prepared profit forecasts and asset valuations).[154] Occasionally these disclosures and circulars might be used as a defensive tactic, but their effectiveness is questionable.[155] In light of the board's dearth of defensive options, it logically follows that it has less leverage to ensure that shareholders get the maximum value for their shares, less time to make their case to the shareholders and search out value-enhancing alternative transactions.[156] Since there are virtu-

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serves to protect both the target and its shareholders.

[153] TAKEOVER CODE, *supra* note 150, R. 21.1. Additionally, the "Duty to promote the success of the company" is codified in more general terms in The Companies Act, 2006, c. 2, § 172 (U.K.). *See also* Hogg v Cramphorn Ltd [1967] Ch. 254, 261 (holding directors could not issue shares for the sole purpose of preventing a hostile takeover).

[154] TAKEOVER CODE, *supra* note 150, R. 25. The only other known defense, aside from disseminating information to shareholders, is to coax another government entity or agency to initiate a judicial or administrative proceeding or investigation. *See* VON BISMARK, *supra* note 143, ¶¶ 767–70. In the case of Farmers Insurance, Farmers a subsidiary of B.A.T., lobbied U.S. state regulators to persuade them they had jurisdiction over the takeover launched against B.A.T. and that the takeover required their consent before it could be completed. Panel Statement 1989/20 (Sept. 15, 1989) re. B.A.T. Industries, at 1, http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/12/1989-21.pdf. While this maneuver effectively delayed the deal for nearly a year, the Panel concluded it did not violate the Code. The key factor, however, was that the state regulators had taken the initiative to participate in reviewing the transaction. In another case earlier that year, however, the Panel held that a target firm violated the Code by engaging in impermissible defensive activities by suing under Section 7 of the Clayton Act to procure an injunction against the takeover. Panel Statement 1989/07 (May 9, 1989) re. Consolidated Gold Fields Plc., at 2, http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/12/1989-07.pdf. Even though Section 7 allowed private companies to bring suits to enforce the antitrust provisions of the Act, neither federal nor state officials had intervened to stop the transaction. *Id.* at 8–9. The Panel reasoned that the target alone was causing the delay by injunction, so it ordered the target firm "to discontinue its litigation forthwith, unless it is approved by shareholders." *Id.* at 24. In other words, a government apparatus must intervene before the Panel will brook delay.

[155] *See Acting in the interests of the company as a whole*, 3 PALMER'S COMPANY LAW 12.299.28 (2015). The board of directors might be able to avoid contravening General Principle 3 and Rule 21 using such disclosures by arguing "that a particular bid is at a fair price but that it is not in the interests of the company as a whole." *Id*. This strategy was employed by Manchester United, "when the board, consistently with its duties under the Code, advised shareholders that the price offered by [acquirer] was fair, but also stated that the financing structure meant that it was not in the interests of the company." *Id.*

[156] That is not to say that the U.K. system does not treat shareholders fairly, only that it might not afford shareholders the most value per share in a takeover as would the U.S. or Canadian system. Indeed, there are several shareholder protective provisions. For instance, Rule 9 requires an acquirer to make a cash or cash alternative offer if its interests in the target's shares reach or exceed a 30% voting stake in the target; all shareholders must receive the highest price the acquirer paid for such shares in the last year. TAKEOVER CODE, *supra* note 150, R. 9. Additionally, "when interests in shares carrying 10%

ally no methods by which a U.K. firm may defend itself, particularly thorny situations can arise in tender offers.

B. Cadbury's Takeover Reveals Cracks in the System

Consider the takeover of Cadbury by Kraft Foods.[157] In 2010, Kraft Foods acquired the iconic British confectionary company Cadbury, much to the dismay of the British public.[158] To allay concerns that the acquisition would cause job losses in the United Kingdom, Kraft promised in its takeover proposal and in its testimony before the committee that it would keep open its factory in Somerdale.[159] Kraft later reneged on this promise, to the outrage of the public and Westminster.[160] The committee remonstrated Kraft's "cynical ploy," and then sought answers.[161] Echoing concerns that have been raised by Hu and Canadian regulators, the committee opined "that the takeover of Cadbury by Kraft was ultimately decided by institutional investors motivated by short-term profits rather than those investors who had the company's long-term interests at heart."[162] The committee suggested that only direct intervention by either the government or the Panel would be sufficient to overcome the problematic institutional shareholder

or more of the voting rights of a class have been acquired by an offeror (i.e. a bidder) in the offer period and the previous twelve months, the offer must include a cash alternative for all shareholders of that class at the highest price paid by the offeror in that period. *Id*. at R. 11. Further, if an offeror acquires for cash any interest in shares during the offer period, a cash alternative must be made that price at least." *Id.* Taken together with Rule 1, Rules 9 and 11 ensure all shareholders get the same deal regardless of when they sell their shares, but the rules do not ensure they get the best possible deal because they do not allow the board sufficient independent negotiating leverage.

[157] BUSINESS, INNOVATION, AND SKILLS COMMITTEE, MERGERS, ACQUISITIONS AND TAKEOVERS: THE TAKEOVER OF CADBURY BY KRAFT, 2009–10, H.C. 234 (U.K.) [hereinafter BIS COMMITTEE REPORT], http://www.publications.parliament.uk/pa/cm200910/cmselect/cmbis/234/234.pdf.

[158] Rupert Steiner, *400 Cadbury's workers sacked after Kraft confirms factory will close just ONE WEEK after U.S. firm promised to keep it open*, DAILYMAIL.COM (London), Feb. 10, 2010, http://www.dailymail.co.uk/news/article-1249728/Cadbury-sacks-400-workers-Kraft-breaks-promise-shut-factory.html. Public outcry regarding the deal, particularly Kraft's reneging on its promise to protect jobs, spurred MPs to haul Kraft executives before the Commons business select committee just two months after the merger deal closed. Zoe Wood, *Kraft to shed 200 British jobs but denies breaching no-cuts pledge to MPs*, THEGUARDIAN.COM (London), Dec. 6, 2011, http://www.theguardian.com/business/2011/dec/06/kraft-axes-200-uk-jobs. These losses mounted through 2011. Id. The discontent was heard all the way across the Atlantic, too. *See* Alistair MacDonald, *Foreign Takeovers Take a Toll in U.K.—Kraft's Acquisition of Cadbury Feeds Discontent That Nation Is Losing Locally Controlled Industries*, WALL STREET JOURNAL, Jan. 27, 2010, at A11.

[159] BIS COMMITTEE REPORT, *supra* note 157, ¶¶ 1–5.

[160] *Id.* ¶¶ 19–20. One publication noted the takeover had "attracted an amazing amount of vitriol." Peter Crush & Jonathan Chocqueel-Mangan, *Heading for meltdown?*, HUMAN RESOURCES, June 2010, at 26.

[161] BIS COMMITTEE REPORT, *supra* note 157, ¶¶ 1–5.

[162] *Id.* at 30.

behavior caused by short-term financial incentives.[163]

UK Business Secretary Lord Mandelson echoed the Committee's concerns in a speech to business community leaders in early 2010.[164] He noted that increased public ownership of shares through retirement accounts means average shareholders ignore corporate governance while fund managers make all the decisions about buying and selling stocks.[165] Like many academics, Lord Mandelson warned that fund managers' "incentives may require them to deliver returns on short timeframes, even if they manage pensions for people whose key interest lies in the long term."[166] The Secretary highlighted the risks posed by linking CEO compensation to short-term gains in share prices and making share price increases "a corporate strategy in itself."[167] In large part, Lord Mandelson argued that "rewarding clever readers of the market more than industrial innovation, quality management, or entrepreneurial skill" does not build companies in the manner that is best for Britain.[168] The Business Secretary claimed that the 2006 Companies Act was designed "to encourage the right kind of long-termism among company directors," and called for "an equivalent long-termism among company owners, especially institutional shareholders."[169] His recommendations included raising the approval threshold for a change of control transaction to two-thirds of voting shares and imposing a duty of stewardship on fund managers requiring them to consider the long-term interests of the companies in which they have invested.[170]

Surprisingly, the Government took no actions in response to the findings by the Committee on Business, Innovation, and Skills or Lord Mandelson's proposals. Instead, the Takeover Panel publicly censured Kraft,[171] enhanced disclosure requirements, and created a "put up or shut up" rule.[172]

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[163] *Id.* at 30–31.

[164] Lord Mandelson, Speech at the Annual Trade and Industry Dinner, Mansion House (Mar. 1, 2010), http://webarchive.nationalarchives.gov.uk/20100304014526/http://www.bis.gov.uk/mansion-house-speech. *See also* Tim Webb, *Lord Mandelson Calls for Overhaul of Takeover Rules*, GUARDIAN (Mar. 1, 2010, 5:30 PM), http://www.theguardian.com/business/2010/mar/01/lord-mandelson-mansion-house-keynote (reporting that "Business secretary says . . . that directors should act more like 'stewards' than 'auctioneers.'").

[165] *Id.*

[166] *Id.* This view is shared by many. *See, e.g.*, Coffee & Darius, *supra* note 31, at 4; Allaire & Dauphin, *supra* note 32, at 6; Strine, *supra* note 15, at 455.

[167] Lord Mandelson, Speech at the Annual Trade and Industry Dinner, Mansion House (Mar. 1, 2010), http://webarchive.nationalarchives.gov.uk/20100304014526/http://www.bis.gov.uk/mansion-house-speech.

[168] *Id.*

[169] *Id.*

[170] *Id.*

[171] Elizabeth Rigby & Brooke Masters, *Kraft Given Food for Thought*, FIN. TIMES (London), May 27, 2010, at 18.

[172] TAKEOVER CODE, *supra* note 151, R. 2.6. The "put up or shut up rule" embodied in Rule 2.4(b) requires a target corporation to name any acquirer with which is negotiating or that approaches it once

The Panel promulgated these new rules in late 2011. The Panel claimed the goal of the 2011 Amendments to the Takeover Code was to "increase the protection for offeree companies . . . against protracted 'virtual bid' periods" by requiring bidders to identify themselves when making their bid announcement and to declare their firm intention to make an offer within twenty-eight days of announcing their bid.[173] The Panel also asserted that it was "strengthen[ing] the position of the offeree company by . . . clarifying that . . . boards are not limited in the factors that they may take into account in giving their opinion on an offer."[174]

In other words, the Panel touts the ability of the board to state its mind as protective, ignoring the reality that boards have little authority to defend themselves save sending shareholders urgently worded letters. Lord Mandelson's suggestions appear to have gone nowhere; the threshold for a change-of-control transaction remains stuck at fifty percent, rather than two-thirds. This means that despite the shareholder protections offered by the Takeover Code, the boards of British companies lack any real leverage to negotiate with acquirers, hostile or otherwise. Without the leverage of defensive tactics, the board cannot induce a buyer to offer the appropriate price for control of the company.[175]

In the more recent case of *Eclairs Group Ltd*, the UK Supreme Court confirmed that in the UK board neutrality is so paramount as to prevent a target board from attempting to thwart a corporate raider whose goal "was to depress the values of the [target's] shares so as to enable [the raider] to buy other shares more cheaply" and seize control of the target's subsidiary without paying full price.[176] More specifically, Eclairs Group and its affiliate Glengary sought to purchase shares in JKX, but the raiders—in an effort to keep down the share price—did not disclose their arrangement to work together when the Board demanded information on the raiders' holdings (lawfully under both statute and the articles of incorporation).[177] Even

the negotiations or approach are made public. After the negotiation or approach is publicly identified, the acquirer has 28 days to make a bid or it will have to wait six months before it can bid on the target again. *See* Steven D. Solomon, *British Takeover Rules May Mean Quicker Pace but Fewer Bids*, N.Y. TIMES DEALBOOK (Sept. 19, 2011 12:58 PM), http://dealbook.nytimes.com/2011/09/19/new-british-rules-will-speed-up-the-pace-of-takeovers/ (explaining many of The Takeover Code 2011 amendments in general terms). As it turns out, the "put up or shut up rule" effectively prevents acquirers from disrupting a potential target's day-to-day business operations by making public statements or leaking details about the deal under negotiation. *See* Aaron Kirchfeld & Matthew Campbell, *Bankers Chafe Under U.K. Takeover Rules*, BLOOMBERG (Sept. 4, 2013), http://www.bloomberg.com/news/print/2013-09-04/bankers-chafe-under-u-k-takeover-rules-that-embolden-targets.html.

[173] THE TAKEOVER PANEL, *Review of the 2011 Amendments to the Takeover Code,* at 1 (Nov. 26, 2012), http://www.thetakeoverpanel.org.uk/wp-content/uploads/2012/01/2012-8.pdf.

[174] *Id*.

[175] *See* Strine, *supra* note 15, at 460.

[176] Eclairs Group Ltd. v. JKX Oil & Gas Plc., [2015] UKSC 71, ¶ 25 (Can.).

[177] *Id*.

though JKX's directors had reason to believe the responses the raiders provided were inaccurate, the target subsequent decision to strip Eclairs Group from voting its shares was reversed by the UK Supreme Court because JKX's board acted partly to thwart a takeover by the raiders.[178] In other words, "the board neutrality policy effectively overrides the directors' belief that they are acting in the best interests of shareholders."[179] This level of helplessness is unacceptable.

Eclairs held 27.55% and Glengary held 11.45% of JKX's shares, which aggregates to 39%. This exceeds the 30% mandatory bid threshold (under Rule 5.1) requiring acquirers like the raiders to put in a tender offer for all outstanding shares at a price equal to what the acquirers paid over the last year.[180] By failing to disclose their plan Eclairs Group and Glengary purchased an unfairly inexpensive extra 9% stake in JKX that should have been purchased as part of a mandatory bid, yet UK law leaves no room for corporate boards to unilaterally thwart this kind of behavior with defensive tactics like a low-threshold shareholder rights plan.

C. The United Kingdom Should Adopt the Canadian Rule

Adopting the Canadian Rule in the United Kingdom would be beneficial because it would give boards much needed time to assemble other offers and lobby shareholders while preventing acquirers and those acting in concert from engaging in *fait accompli* tactics. The bargaining position of the board would be reinforced. If the shareholders still like the takeover offer after waiting 105 days, the Takeover Panel can rescind the pill unless the shareholders pre-approve its continuation in advance (or, if they want to hew closer to current UK law, terminate the pill immediately). This gives the target board more than the usual sixty days provided under Takeover Code Rule 31.6 to secure an alternative transaction, persuade shareholders that transaction is preferable, or persuade shareholders from tendering at all. Had it been in place during the Cadbury takeover, Cadbury's board might have been in a better negotiating position such that it could have secured terms binding Kraft to its commitments to keep jobs in the United Kingdom.

The Canadian rule would also help to encourage long-term investing and "patient but engaged ownership"[181] that can benefit stakeholders and

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[178] *Id*. ¶¶ 41–43.

[179] Sam Bagot, *Staying Neutral – UK Supreme Court Re-emphasizes Primacy of Board Neutrality When Battles for Corporate Control Arise*, CLEARY M&A & CORPORATE GOVERNANCE WATCH (March 22, 2016), http://www.clearymawatch.com/2016/03/staying-neutral-uk-supreme-court-re-emphasizes-primacy-of-board-neutrality-when-battles-for-corporate-control-arise/.

[180] Eclairs Group Ltd., [2015] UKSC 71, ¶ 25.

[181] Lord Mandelson, Speech at the Annual Trade and Industry Dinner, Mansion House (Mar. 1, 2010), http://webarchive.nationalarchives.gov.uk/20100304014526/http://www.bis.gov.uk/mansion-

shareholders alike. Lord Mandelson argued that the duties imposed on directors by § 172 of the Companies Act of 2006 require "directors to consider the best outcome for a company in the long term, considering the interests of all the stakeholders – employees, suppliers, and its brands and capabilities."[182] Lord Mandelson even acknowledged that "[g]etting a higher price in a takeover may not be a perfect proxy for [those interests]."[183] Still, without adopting the Canadian Rule allowing the board to adopt the most effective takeover defenses, § 172 offers hollow hope of increased negotiating power because the Takeover Code operates as a separate duty.[184] Rule 21 flatly forbids the board from taking any defensive action without shareholder approval.[185] Authoritative practitioners attempting to reconcile Rule 21 with § 172 do not even consider the possibility of defensive tactics without shareholder authorization.[186] If the panel were to adopt the Canadian Rule, then Rule 21's prohibition would be partially repealed, thereby allowing directors the freedom under the Companies Act to seek the best outcome for the company long-term (which is incidentally in their best interest).

The Canadian Rule is not without its detractors. Jennifer Payne of Oxford University argues that similar rules allowing only "original" shareholders (shareholders who are neither the bidder nor its affiliates) the right to vote on change of control transaction are "undesirable."[187] Professor Payne suggests these rules must not be implemented in the United Kingdom because they "appear contrary to the principle of equality stated in the Takeover Directive and in General Principle 1 of the Takeover Code."[188] General Principle 1 states that "[a]ll holders of the securities of an offeree company of the same class must be afforded equivalent treatment; moreover, if a person acquires control of a company, the other holders of securities must be protected."[189]

Equality among offeree-shareholders is primary concern of takeover regimes in the United States[190] and Canada[191] as well. The Canadian Rule

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house-speech.

[182] *Id.*

[183] *Id.*

[184] *See* VON BISMARCK, *supra* note 144, ¶¶ 763–64 (2013).

[185] TAKEOVER CODE, *supra* note 151, R. 21.1.

[186] *See* Jonathan Mukwiri, *Directors' Duties in Takeover Bids and English Company Law*, 19 INT'L CO. & COM. L. REV. 281, 285–86.

[187] PAYNE, *supra* note 6, at 124.

[188] *Id.* at 124 n.189.

[189] TAKEOVER CODE, *supra* note 151, Gen. Princ. 1.

[190] *See* Cavalier Oil Corp. v. Harnett, 564 A.2d 1137, 1146 (Del. 1989) (rejecting attempt to pay minority stockholders less for their stocks); Delaware General Corporate Law ("DGCL"), DEL. CODE ANN. tit. 8, § 262(a) (West 2014) (procedure for ensuring dissenting shareholders paid adequately); 17 C.F.R. § 230.801(a)(3) (2015) (SEC equal treatment rule).

[191] One fundamental way the securities laws protect shareholders is "by requiring that all securi-

does not offend underlying policy rationale for General Principle 1 because allowing only original shareholders to vote on whether to rescind the shareholder rights plan helps ensure that all shareholders get a better price if the company is sold. The Canadian Rule enhances the consideration paid to all shareholders for the control stake. Hence, the Canadian Rule actually furthers the General Principles under the Code. Finally, reforming the United Kingdom's takeover system would be very easy logistically.[192] The Canadian proposed rules could be adopted unilaterally by The Takeover Panel, taking advantage of existing institutional frameworks and knowledge while still allowing British shareholders to benefit from maximized value at the time of sale. At the same time, using the Canadian rule will not overtax the panel because, as was explained in the American context, the rule governs voting procedures which are easily administered.

In mid-July 2016, UK Prime Minister Theresa May indicated in her first major policy speech plans to scrutinize foreign takeover bids to ensure they are in the national interest.[193] Prime Minister May expressed unambiguous opposition to foreign acquisitions of strategically important British businesses and cited the takeover of Cadbury and near-takeover of AstraZeneca as transactions her government would have blocked.[194] However, when faced with the sale of British computer chip designer ARM to a Japanese firm, both the PM and Chancellor Philip Hammond expressed their full support.[195] Only time will tell whether May's early pronouncements were mere posturing or whether a more formal public interest review procedure will be put in place. However, given the difficulties Canada experienced with securities commissions exercising free-wheeling public interest discretion (albeit to facilitate rather than forestall takeover bids), it might be best to leave the target's board and their shareholders in control.[196] In other

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tyholders are treated equally in price and *pro rata* participation." Re Pulse Data Inc., 2007 ABASC 895, ¶ 93 (citing David Johnston & Kathleen Doyle Rockwell, Canadian Securities Regulation 268–87 (2006)) (Can.). *See also* Re Stornoway Diamond Corp., 2006 BCSECCOM 533, ¶ 36 (citing Re CDC Life Sciences Inc., [1988] 11 OSCB 2541, 2542 (noting that Canadian law seeks to ensure shareholders are treated equally by purchasers)).

[192] Compare this situation with that of the United States where board-protective statutes allowing for poison bills without shareholder votes must be repealed by state legislatures. As noted above, it appears judges cannot make the necessary changes to American system of takeover regulations without completely remaking the doctrine regarding the duty of care as it exists within DEL. CODE ANN. tit. 8, § 141(a) (West 2014).

[193] George Parker, *Theresa May's In-Tray — Brexit, the Economy and Social Reform*, FIN. TIMES (July 13, 2016), https://next.ft.com/content/ce627152-48fd-11e6-8d68-72e9211e86ab.

[194] Robert Peston, *ARM Takeover is Theresa May's First Huge Test*, ITV NEWS (July 18, 2016, 8:03 AM), http://www.itv.com/news/2016-07-18/arm-takeover-is-theresa-mays-first-huge-test/.

[195] *Id.*

[196] If the Prime Minister did decide to implement this policy, it would seem inappropriate to lodge the public interest review authority with the Takeover Panel as it is presently constituted, if only because the Panel's remit has always been to protect shareholders rather than stakeholders (i.e. employees), let alone the national interest. *See* Kenju Watanabe, *Control Transaction Governance: Collective Action and*

words, if shareholders want to sell, let them, but give the boards of directors enough time to mount a viable defense if they believe it is in the best interests of the company and the shareholders in the long-run. Allowing for shareholder rights plans and a Canadian-style extended deposit period accomplishes this goal.

D. Schemes of Arrangement Unaffected by Canadian Rule

The Canadian Rule is also advantageous because it cures the pathological weakness of corporate boards in the normal British takeover regime without causing additional problems for other methods of accomplishing takeovers. In addition to the traditional tender offer to shareholders most associated with the Takeover Panel, UK law provides another way for acquirers to gain control of a company: the scheme of arrangement.[197] A scheme is defined as a "compromise" or "arrangement" between a company and its creditors or shareholders ("members" in the language of the Act).[198] At the very least, any arrangement must involve some minimal element of reciprocal concessions.[199]

While initially used for reorganization of insolvent companies, schemes of arrangement are an increasingly common takeover method for widely held companies in the United Kingdom.[200] To oversimplify, a scheme operates like a Chapter 11 bankruptcy. A creditor, shareholder, or the company proposes a scheme of reorganization in court, and then the creditors and shareholders vote in classes to approve the scheme.[201] If 75% of a class votes to approve the scheme, the court compels the 25% minority to accept it.[202] Then a court blesses the plan as fair and equitable, and all parties are bound by the agreement.[203]

An advantage of a scheme of arrangement is that an acquirer needs to secure the votes of only 75% of each class to compel minority shareholders to sell their stakes, whereas squeeze-out mergers are available only when an acquirer has obtained 90% of the outstanding shares.[204] While this makes it easier to gain 100% control of the target corporation when the takeover is friendly, a hostile takeover via a scheme is much more difficult because the

Asymmetric Information Problems and Ex post Policing, 36 NW. J. INT'L L. & BUS. 45, 139–42 (arguing that gatekeeping functions in corporate change-of-control transactions must be entrusted to institutions having both the skill and predisposition to enforce them).

[197] The Companies Act, 2006, c. 46, § 895 (U.K.).

[198] *Id.* § 895(1).

[199] PAYNE, *supra* note 6, at 21.

[200] *Id.* at 86. Schemes of Arrangement are mentioned in this paper only because of their increasing frequency. It is highly unlikely that a hostile takeover could be accomplished using a scheme.

[201] The Companies Act, 2006, c. 46, § 896(2) (U.K.).

[202] PAYNE, *supra* note 6, at 4.

[203] *Id.* at 3.

[204] *Id.* at 95–96.

acquirer needs to obtain the votes of 75% of the voting shares. This is made even harder because the court will not count acquirer's shares or those owned by entities affiliated with acquirer.[205] Like the Canadian rule, only the "original" shareholders votes count, but the scheme requirements demand not 50% approval but 75%. This means adopting the Canadian rule will not increase the number of takeover schemes compared to offers since the ability to rescind the poison pill makes it no easier to accomplish a scheme. Detractors of the Canadian rule cannot find support in any pretended effects on the scheme of arrangement mechanism.

VI. CONCLUSION

Canada, the United States, and the United Kingdom all have problems with their respective systems of regulating takeovers. In Canada, an overzealous application of public interest jurisdiction by regulators created uncertainty and arguably began to impugn the will of shareholders by rescinding SRPs and forcing votes on bids shareholders did not want to vote on. The Canadian solution resolved the problem by leaving the ultimate question of whether the pill must go to shareholders. Both the American and British takeover schemes could benefit from the Canadian example.

In the United States, state statutes and judicial precedent have made the American corporate board essentially an impenetrable fortress leaving shareholders and acquirers with nearly insurmountable barriers to rescinding a poison pill. Adopting the Canadian rule would maintain the board's negotiating flexibility while making them accountable to the true owners of the company.

The United Kingdom has the exact opposite problem. British boards suffer from a lack of negotiating power and are unable to maximize shareholder value to the same degree as their Canadian and American counterparts. Adopting the Canadian rule preserves share-holder primacy while giving directors needed leverage in a bidders market.

In sum, three countries, three different problems, and Canada provides one elegant solution.

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[205] *Id.* at 143.