Focus BUSINESS LAW

Changing landscape of Canadian takeover law


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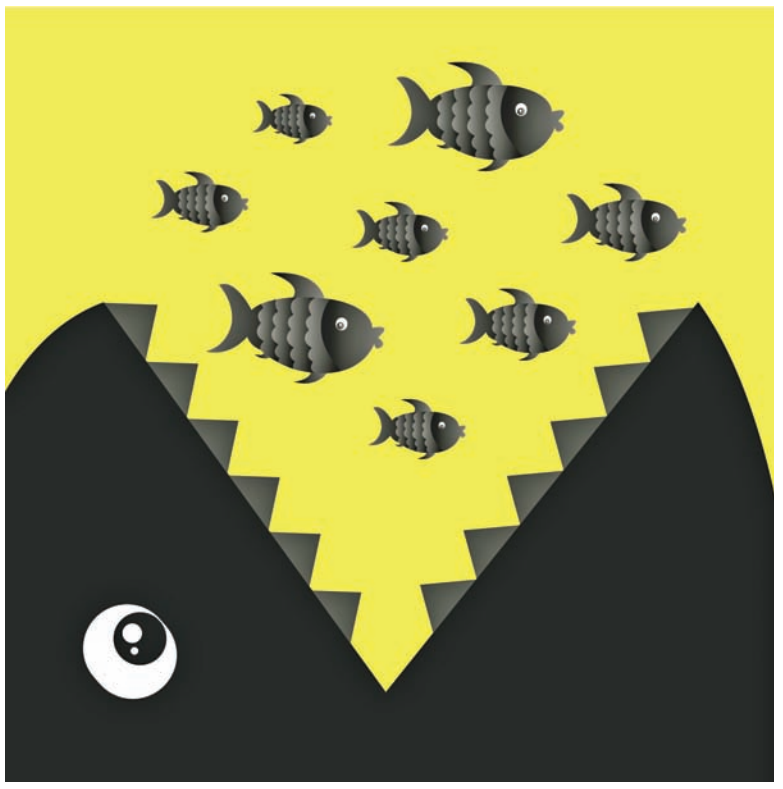
Over the past decade we have witnessed a surge of global corporate takeovers that have challenged the Canadian legal system with respect to assessing the rights and obligations of the implicated parties. What are the directors' fiduciary duties in such situations? What elements should they evaluate in the takeover context? Can they prefer the interests of some stakeholders over others?

The Supreme Court rendered its landmark decision in *BCE Inc. v. 1976 Debentureholders* 2008 SCC 69. The facts of the case are as follows: the BCE board of directors formed a strategic surveillance committee, which decided to go forward with a bidding process. Upon the completion of the bidding process, three groups, including the Ontario Teachers Pension Plan (Ontario Teachers), submitted offers. Each group envisioned the privatization of BCE through a leveraged buyout that involved significant debt to be assumed by the target. Following negotiations with the three groups, the board of directors accepted the offer of Ontario Teachers at $42.75 per share, representing a transaction valued at approximately $52 billion. As the transaction in question would affect the value of the debentures, the debentureholders initiated legal action to stop the transaction.

At that time Canadian case law was not "mature" regarding the balancing of interests a board of directors had to undertake in the context of a corporate takeover. Canadian legal advisers therefore turned to the law of Delaware, which had more extensive experience dealing with takeovers.

Following the *Unocal* v. *Mesa Petroleum* 493 A.2d 946 (Del. Supr. 1985) case, the board of directors has discretion, in the context of a hostile bid, to use defensive measures and to prevent the offer from being put to the shareholders for approval if the bid is not in the best interests of the corporation. However, in such a context, the courts will exercise "Enhanced Judicial Scrutiny" vis-à-vis the decision of the board, rather than the more classic rule of deference, commonly referred to as the business judgment rule. The purpose is to sanction the use by directors of defensive measures to protect their own interests, rather than those of the corporation.



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In *Air Prods. & Chems., Inc.* v. *Airgas, Inc.* 16 A.3d 48 (Del. Ch. 2011), the directors of the target company were allowed to "just say no" to an inadequately priced hostile bid threatening their long-term business plan, by using a poison pill in combination with its staggered board to avoid that the bid be considered by the shareholders.

However, when a board of directors proactively decides to engage in a transaction where the control of the target corporation will pass to another suitor, there is no longer any rationale to let the target directors protect their own long-term business plan. The Delaware courts were therefore reluctant to apply, in such situations and "as is," the *Unocal* analysis. In such a context, the Delaware Supreme Court decided in the classic *Revlon, Inc. v. MacAndrews & Forbes Holdings Inc.* 506 A.2d 173 (Del. Supr. 1986) case that to discharge their fiduciary duties, directors must maximize short-term share value. In other words, when the corporation goes from (a) the "Unocal zone," where the directors are protecting their own long-term business plan to (b) the "Revlon zone," where the directors are handing over the control of the corporation, Delaware law adjusts from a "director-centric" regime to a "shareholder-centric" regime. In the "Unocal zone," the directors usually get to ultimately decide the fate of the hostile bid, whereas in the "Revlon zone," this decision usually belongs to the shareholders.

Coming back to the *BCE* case, the central issue for the Supreme Court was whether the BCE directors had breached their fiduciary duties by favouring short-term share value within the *Revlon* framework, to the detriment of the interests of the debentureholders. In other words, in favouring the transaction in question, were the BCE directors allowed to give priority to the interests of one group of stakeholders within the corporation, its shareholders, to the detriment of another, the debentureholders?

The court indicated that *at all times*, the fiduciary duties of the directors are owed to the corporation and in considering what is in the *best interests of the corporation*, directors may look to the interests of a specific group of stakeholders and their decision in that regard will be protected by the business judgment rule. As such, the court favoured a director-centric regime, enabling the directors to decide which stakeholders should be advantaged considering the particular context, the whole in furtherance of *the long-term interests of the corporation*.

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In the context of a change of control transaction, the court suggested that the *best interests of the corporation* may, depending on the circumstances, align with short-term share value maximization. In other circumstances, the best interests of the corporation may align with the interests of other stakeholders.

In conclusion, before *BCE*, when facing a hostile bid in Canada, directors were essentially required to focus on the short-term interests of shareholders, representing a Canadian integration of the *Revlon* case law. However, *BCE* made it clear that this is no longer necessarily the case, and that directors must take into account the best interests of the corporation, which implies that they may favour the interests of shareholders or, in certain circumstances, the interests of other stakeholders. Canadian law has therefore integrated a mix between the *Unocal* and *Revlon* line of authorities, and we now stand to see how other takeover contests, factually different than in *BCE*, will be dealt with by the courts in Canada.

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Drug charge result of misdialed text

Information technology is a wonderful thing, until of course it isn't. That's what Dwayne Herbert, a 39-year-old Louisiana man learned when he allegedly misdialled a text message offering to sell methamphetamine and finalize delivery details, reports mrctv.org. Unfortunately for him the text was sent to an Assumption Parish Sheriff's deputy who alertly played along by arranging a meet at a specific location while he simultaneously alerted the narcotics division. When Herbert, who was out on a $90,000 bond from a previous arrest involving the alleged operation of a meth lab out of a boat, arrived at the location he was met by a team of narcotics deputies and arrested with what police say was two firearms and a quantity of crystal meth. Police say Herbert has been charged with possession of a firearm in the presence of a controlled, dangerous substance, possession of methamphetamine with intent to distribute and two counts of resisting an officer. – **STAFF**