TAKEOVERS AND THE DUTIES OF THE BOARD OF DIRECTORS: COMPARATIVE ASPECTS OF AMERICAN AND CANADIAN STANDARDS

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La toute dernière vague d'acquisitions corporatives a donné lieu à une véritable levée de boucliers parmi les sociétés susceptibles de faire l'objet de telles acquisitions. Cette situation a donné lieu à une foule de stratégies défensives. L'adoption de ces stratégies défensives par le conseil d'administration de sociétés cibles, face à une menace d'acquisition hostile, et leur mise en oeuvre (ou l'absence de leur mise en oeuvre) a souvent conduit à des litiges longs et coûteux. Bien que ce phénomène s'observe beaucoup plus souvent aux Etats-Unis, un nombre sans cesse croissant de sociétés canadiennes adoptent des stratégies défensives similaires dont la validité risque, ultimement, d'être sanctionnée par les tribunaux.

Dans cet article, l'auteur scrute le développement des diverses normes actuellement exigées des conseils d'administration dans leurs réactions face aux menaces d'acquisitions, réelles ou alléguées, par les tribunaux américains. L'auteur tente également de découvrir dans quelle mesure ces normes sont applicables au Canada et quelles sont les caractéristiques distinctes de la législation canadienne en matière corporative et plus particulièrement en matière d'acquisitions.

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The most recent wave of corporate takeover activity has led to a myriad of takeover defence strategies. Adopted by the Board of Directors of target companies in reaction to a hostile takeover, their implementation, or failure to do so, has often led to protracted and costly litigation. While this phenomena is much more wide-spread in the United States, more and more Canadian companies are adopting similar takeover defences, the validity of which may ultimately end up being decided by the courts.

In this article, the author examines the development of the standards currently applied by the courts in the United States to Board of Directors' responses to real or perceived takeover threats, to what extent these standards have similar application in Canada as well as the distinguishing features in Canadian corporate and takeover legislation which may account for notable differences.

SUMMARY

INTRODUCTION 133

Part I 133

Part II 141

Part III 148

CONCLUSION 152

INTRODUCTION

The purpose of this paper is to examine the duties of the Board of Directors of a target company during a hostile takeover. This paper will focus on the similarities as well as the differences between the prevailing standard in the United States and in Canada in order to determine whether the business judgment rule, as developed by the American caselaw, has similar application in Canada in scrutinizing Board of Directors' responses to actual or perceived takeover threats.

Part one of this paper will describe the legislative framework for the regulation of takeovers and will then examine the development and present status of the business judgment rule as applied to Directors' decisions in the course of a hostile takeover in the American context. Part two will describe the Canadian legislative framework and will then examine the development of the standard presently applied by Canadian courts.

Part three of this paper will discuss some of the differences between American versus Canadian corporate and takeover legislation and how these differences may account for variations in the judicial scrutiny of Directors' decisions.

Part I

A takeover has been defined as a «transaction or series of transactions whereby a person (individual, group of individuals or company) acquires assets of a company either directly by becoming the owner of those assets or indirectly by obtaining control of the management of a company»[1]. Most commonly, a takeover is an attempt by a bidder to acquire control of a subject company (the target) through the acquisition of some or all of its outstanding shares[2]. This is usually accomplished by the bidder offering to the shareholders of the target cash or securities in exchange for the target's stock[3].

Takeovers of public companies can take many different forms; however, most takeovers in the United States have at their origins at least an unsolicited or unfriendly bid[4]. In the United States, the takeover bid is regulated at the federal level by the Williams Act (the Act). The Act, the provisions of which are incorporated into the 1934 Securi-

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1. H. Weinberg & B. Blank, Takeovers and Mergers, (1979), 3.
2. M. Lipton & E. Steinberger, Takeovers and Freezeouts, (1978), 1-6.
3. Id. at 1-8.
4. Id. at 1-6.

ties Exchange Act, was enacted by Congress in 1968 as a response to the relatively large number of takeovers during the so-called «third great merger wave»[5]. The Act focuses on full disclosure and dissemination of information and imposes restrictions designed to prohibit discrimination among tendering shareholders and to permit investors sufficient delays in making their investment decisions[6]. The Act was not intended to effect the outcome of tender offers and «extreme care was taken to avoid tipping the balance of regulation either in favour of management or in favour of the person making the takeover bid»[7].

The terms «tender offer» and «takeover bid» are not defined by the Act and it has been left to the courts to determine whether certain securities transactions constitute tender offers[8]. The courts have also affirmed that the Act does not regulate the substantive context of tender offers and has left to state law its traditional role in regulating the fairness of corporate control transactions[9]. In the absence of any alleged violation of the Act there lies no recourse under federal securities laws with respect to the fairness of the transaction.

Much of the litigation precipitated by takeovers involves derivative actions or class action law suits taken by aggrieved shareholders of the target company seeking compensation from the Directors of the target alleging breaches of fiduciary duty. Increasingly however, litigation has involved «transactional justification» where an injunction is sought against Board action (i.e. to force the Board to redeem a poison pill or to block a recapitalization) and the focus of judicial scrutiny is on the decision itself as opposed to the potential liability of the Directors[10].

During the course of a hostile takeover, the Directors of the target often find themselves in a no-win situation; if they act in a hasty fashion and accept a takeover or merger then they may be found liable for having sold the company at too low a price without adequately having considered other alternatives or without having solicited competing and possibly higher bidders[11]. On the other hand, if the Direc-

5. J. Brooks, The Takeover Game, (1987), 174.
6. Gelfond and Sebastian, Reevaluating the Duties of Target Management in Hostile Tender Offer, 60 B.U.L.R. 403 (1980), 407.
7. 113 Cong. Rec. 24664 (1967) (remarks of Sen. Williams).
8. See, e.g., Hanson Trust PLC v. SCM Corporation, 774 F.2d 47 (2d Cir. 1985) and SEC v. Carter Hawley Hale Stores, Inc. 760 F.2d 945 (9th Cir. 1985).
9. Schreiber v. Burlington Northern Inc., 472 U.S. 1 (1985).
10. Sparks, Balotti & Abrams, Fiduciary Duties in Corporate Control Contests, in Hostile Battles for Corporate Control, 2 (PLI 1987), 19.
11. See, e.g., Smith v. Van Gorkham, 488 A.2d. 858 (S.C. Del. 1985).

tors pursue an aggressive defense against a takeover and the defense is successful in warding off the takeover bid, then the Board may be found liable for having entrenched inept management and for not having maximized shareholder wealth[12]. Given the difficulty in resolving this conflict, the courts have maintained that, absent any evidence of self-dealing or fraud, the decisions of the Directors of the target are protected by the business judgment rule[13].

Simply stated, the business judgment rule is a presumption in favour of the Board of Directors having fulfilled their fiduciary duties when they have taken action in good faith, after reasonable investigation into the best interests of the corporation and its shareholders and it is clear that the Board has no personal interest in the transaction[14]. In other words, in the absence of self-dealing or bad faith, the courts will be reluctant to interfere with a Board's informed business decision and will not substitute its own notion of what is sound business judgment[15].

The logic of this doctrine is premised upon the following: a) the shareholders chose the Directors to run the company and have mandated these Directors to manage the affairs of the company[16]; b) the need to encourage competent people to become Directors without being exposed to unlimited liability; and c) the lack of expertise of the courts to engage in meaningful review of business decisions[17].

The application of the business judgment doctrine to transactions affecting corporate control is particularly problematic due to the inherent conflict between the Board of Director's interest in preserving its own position and its duty to act in the best interests of the shareholders[18]. The Board's position is further complicated by the fact that they must decide between two classes of shareholders, the bidder, who has

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12. See, e.g., Panter v. Marshall Field & Co. 646 F.2d 271 (7th Cir. 1981).
13. Pogastin v. Rice, 480 A.2d 619 (S.C. Del. 1984). The courts have recognized that takeover defenses are a double edged sword in that they may be used to thwart a raider's attempt to gain control or they may also be used as leverage in the Board's negotiation to get a higher price for the sought after shares.
14. See, Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971). Aronson v. Lewis, 473 A.2d 805 (Del. 1984). See also Pitt, Hurwitz & Peters, Takeover Offers: Offensive and Defensive Tactics and the Business Judgment Rule, in Hostile Battles for Corporate Control, 1 (PLI 1987).
15. See, Panter v. Marshall Field & Co., supra note 12, Johnson v. Trueblood, 629 F.2d 287 (3d Cir. 1980) and generally, Howard, Takeover Battles and the Business Judgment Rule, 11 Cdn. Bus. L. Rev. 445 (1980), 450.
16. Johnson, Anti-Takeover Actions & Defenses: Business Judgment or Breach of Duty? 28 Vill. L.R. 51 (1982-83), 62.
17. Sparks, Balotti & Abrams, supra note 10, at 16-17.
18. See, e.g., Unocal v. Mesa Petroleum 493 A.2d 946, 955 (Del. 1985).

already acquired some shares in the target, and the offeree. The Board must consider the long-term effects on the corporation versus the short-term economic interests of shareholders who, enticed by the hefty premium, are willing to accept the bid[19].

Coexisting with the Director's duty of care is the Director's duty of loyalty pursuant to which a Director is held to a higher standard of intrinsic fairness. It is based upon this standard that transactions involving self-dealing, theft of corporate opportunity and salary matters are evaluated[20]. The business judgment rule and the accompanying judicial restraint, premised on an absence of selfdealing, do not apply when the decision of the Directors is influenced by factors which create very real conflicts of interest[21]. It has also been argued that the business judgment rule is only applicable to those decisions involving the ordinary affairs of the company in dealing with third parties however, in a tender offer situation the offer is made directly to the shareholders and therefore is beyond the scope of the rule's application[22].

Recognizing the difficulties inherent in evaluating decisions taken by the Board of Directors in the midst of a hostile takeover, the courts have developed and experimented with, over the years, several different standards of evaluation. Among these approaches are: a) the «primary purpose» test; b) the «any rational purpose» test; and c) the showing of «intrinsic fairness» test[23].

The «primary purpose» test asks whether the Board acted primarily to further a proper corporate purpose or whether the Board's actions were primarily designed to maintain themselves in office[24]. This test has often been applied where a corporation has issued new stock or has repurchased stock in the context of defending against an attempt by an outsider to gain control[25]. This approach is wrought with

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19. Howard, supra note 15, at 450.
20. Gelfond & Sebastian, supra note 6, at 435. See also Weinberger v. UOP, Inc. 457 A.2d 701 (S.C. Del. 1983).
21. Gelfond & Sebastian, supra note 6, at 435.
22. Johnson, supra note 16, at 61-62.
23. See, generally, Gelfond and Sebastian, supra note 6 and Sparks, Balotti & Abrams, supra note 10.
24. Pitt, Hurwitz & Peters, supra note 14, at 38. See also Panter v. Marshall Field & Co. 646 F.2d 271 (7th Cir. 1981).
25. Pitt, Hurwitz & Peters, supra note 14. See also Heit v. Baird 567 F.2d, 1157 (CA 1, 1977) and Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255 (2d Cir. 1984).

definitional and characterization problems which require the courts to conduct a subjective inquiry into the motives of the Board[26].

A second standard developed by the courts is the «any rational purpose» test pursuant to which the Directors have the initial burden of demonstrating that their perception of the threat posed by the takeover was real and that their response to the perceived threat was proportional thereto[27]. The decisions of the Board will then be upheld if they can be attributed to any rational business purpose[28].

Finally, in certain circumstances and especially after there has been a showing that the Board of Directors had reason to favour their own interests over those of the shareholders, the decision will only be sustained if it is objectively or intrinsically fair[29].

Throughout the late 1970's and early 1980's, the preceding tests were applied in a somewhat haphazard fashion. The confusion surrounding the business judgment rule and its application in the context of a takeover was further exacerbated following the landmark decision rendered in Smith v. Van Gorkham[30]. Shortly after the Van Gorkham case, the Delaware courts were once again called upon to apply the business judgment role in the context of a hostile takeover. In Unocal v. Mesa Petroleum[31], the court elucidated a two-step inquiry which has now become the standard for evaluating Directors' decisions taken in the context of a hostile takeover.

Recognizing the inherent conflict faced by the Board, the court in Unocal stated that in order to benefit from the protection of the business judgment rule,

> «the Directors must show that they had reasonable grounds for believing that a danger to corporate policy and

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26. Sparks, Balotti & Abrams, supra note 10, at 23.
27. Ibid.
28. See, e.g., AC Acquisitions Corp. v. Anderson Clayton & Co., 519 A.2d 103 (Del. Ch. 1986).
29. See, e.g., Hanson PLC v. SMC Corporation 774 F.2d 47 (2d Cir. 1985) Weinberger v. UOP, Inc. 457 A.2d 701 (S.C. Del. 1983).
30. 488 A.2d 858 (S.C. Dec. 1985). As a reaction to this decision several articles appeared carefully detailing the appropriate steps to be taken in order to protect directors from liability. See, e.g., Manning, Reflections and Practical Tips on Life in the Boardroom After Van Gorkham, 41 Bus. L.R. 1 (1985).
31. 493 A.2d 946, 955 (Del. 1985).

> effectiveness existed because of another person's stock ownership»[32].

The court also pronounced that:

> «this burden may be satisfied by showing good faith and reasonable investigation ... which proof is materially enhanced by approval of a board comprised of a majority of outside independent Directors»[33].

The second step of the inquiry was to determine whether the defensive measure taken was reasonable in relation to the threat posed.

Provided that these two tests are satisfied then the defensive tactics adopted by the Board will fall within the ambit of the business judgment rule unless the plaintiff can show:

> «by preponderance of evidence that the Directors' decisions were primarily based on perpetuating themselves in office or some other breach of fiduciary duty such as fraud, overreaching, lack of good faith or being uninformed»[34].

In adopting this two-step inquiry, the Delaware courts have shifted the initial burden of proof from the attacking plaintiff to the defendant Directors and have imposed a level of substantive review in assessing the balance between the threat posed and the defensive tactic adopted. Thus, the reasonableness of the target's response will be evaluated by the courts regardless of whether the plaintiff demonstrates that the Directors acted solely or primarily with an improper purpose[35]. Clearly this goes beyond both the presumption in favour of the Directors normally afforded by the business judgment rule as well as the usual judicial restraint in reviewing Director's decisions.

Following Unocal, the Delaware courts have had ample opportunity to either modify or affirm what had been set down in

32. Id., at 955.
33. Ibid.
34. Id., at 958.
35. Sparks, Balotti & Abrams, supra note 10, at 22-23.

Unocal. In Moran v. Household International, Inc.[36], the legality of the Board's adoption of a rights plan (a poison pill) as a preventative mechanism to ward off future raiders was examined. After concluding that the adoption of the plan was within the authority of the Board, the court examined whether the decision to adopt the plan fell within the protection afforded by the business judgment rule. Applying the two-step Unocal inquiry, the court concluded that the Directors, having acted in good faith after reasonable investigation, had adopted the plan as a reasonable reaction to their concerns about a possible coercive, two tier, front end loaded, tender offer and were therefore protected by the business judgment rule[37]. The court placed particular emphasis on the fact that the plan was being adopted as a preventative as opposed to a reactive tactic and left for another day the validity of a plan adopted in the heat of a takeover battle as well as the Board's decision to trigger or redeem such a plan.

In Revlon,Inc. v. MacAndrews & Forbes Holdings, Inc.[38], the Delaware Supreme Court was called upon to evaluate a whole gamit of takeover defenses. Relying on the analysis developed in Unocal, the Supreme Court affirmed the Chancery Court's refusal to enjoin the enforcement of a poison pill adopted by Revlon's Board. The poison pill and the Notes Exchange Offer were held to be «reasonable in relation to the threat posed» in view of the Board's evaluation that the offer was grossly inadequate[39]. These two defenses served the purpose of increasing the offer price; however, once it became inevitable that the company was going to be sold, the Board's role changed from defender of the corporate bastion to auctioneer whose goal was to get the highest possible price for shareholders[40]. The standard of conduct by which the Directors' decisions would be evaluated also changed. The court determined that the subsequent grant of a lock-up clause, a «no-shop» provision and a cancellation fee to a favored party was an effort by management to protect their positions and to reduce their exposure to liability. Under the stricter intrinsic fairness test these actions constituted a breach of the Directors' duties[41].

In some of the more recent takeover battles, the Unocal test continues to be applied by the courts. In Ivanhoe Partners v. Newmont

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36. 500 A.2d 1346 (S.C. Del. 1985).
37. Id., at 1357.
38. 506 A.2d 173 (S.C. Del. 1986).
39. Id., at 176.
40. Id., at 184.
41. Howard, supra note 15, at 462-463.

Mining Corp.[42], a comprehensive defensive strategy which included a street sweep conducted by the company's largest shareholder and facilitated by the payment of a substantial dividend was deemed to be a reasonable response to a coercive and inadequate two tier partial tender offer and therefore protected by the business judgment rule. Similarly, in CRTF Corp. v. Federal Department Stores[43], the Board's refusal to redeem a poison pill was also upheld under the reasonable test.

On the other hand, in Grand Metropolitan PLC v. Pillsbury Co.[44], the Delaware Court of Chancery ruled that the Director's decision to keep a poison pill in place was not protected by the business judgment rule since it was not reasonable in relation to the threat posed by the offeror's fully financed invitation to tender all shares at a fair and adequate price[45].

In Robert M. Bass Group, Inc. v. Evans[46] the target company's defensive restructuring, which included the payment of a large cash dividend and the reorganization of the company's divisions into separate companies, was judged to have failed the reasonable test. The court concluded that the threat to corporate policy was unreasonably perceived given that the takeover bid was neither coercive, front-end loaded, nor dependent on the break-up of the company for its financing[47]. According to the Court, the Board's response of restructuring the company, was also unreasonable as it offered shareholders inferior value and no choice but to accept it[48]. Finally, the response was judged unreasonable because it would entrench the management group and virtually eliminate any possibility of shareholders receiving a takeover premium without management's consent[49].

The preceding review of judicial evaluation of Directors' decisions taken during a hostile takeover reveals that the business judgment rule has undergone a transformation. The two-step reasonable test proposed in Unocal has opened a door through which a limited degree of substantive review by the courts is accepted and

42. 535 A.2d 1334 (S.C. Del. 1987).
43. Federal Securities Law Reports, #1280 (March 18, 1988) 98, 114.
44. Federal Securities Law Reports, #1318 (December 18, 1988) 91, 188.
45. Id., at 91, 195.
46. 522 A.2d 1227 (Del. Ch. 1988).
47. Id., at 1240
48. Id., at 1242.
49. Id., at 1244.

through which the standards to which Directors are held to in arriving at their decision is somewhat more stringent. Bearing this in mind, Directors must now take particular care to ensure that defensive tactics are reasonably related to the particular event or conditions which give rise to their adoption[50].

Part II

Of particular importance in examining the takeover legislative framework in Canada is the primacy of provincial legislation. While takeovers are to some extent regulated under the provisions of the federal corporate statute, the Canada Business Corporations Act (CBCA), it is the respective provincial legislatures which adopt and enforce takeover legislation[51]. The specific provisions pertaining to takeovers are found in each province's Securities Act and throughout Canada there has been a movement towards uniformity of these acts. Since the province of Ontario, the most populous of the 10 provinces, is the acknowledged leader in the field of securities regulation, most of the ensuing discussion will focus on the relevant Ontario statutes.

In accordance with section 88(1) of the Ontario Securities Act (OSA), the term «takeover offer» is defined in such a way that anytime an offer is made to increase the offeror's holdings so that in the aggregate the offeror will hold 20% or more of the target's outstanding securities, a takeover bid is deemed to have been made. Upon the occurrence of such an event, the offeror must prepare a takeover bid circular containing the information prescribed by regulation to be forwarded to the target company, the securities commission and stock exchange as well as to each of the target's securities holders[52]. The OSA also contains statutory requirements prohibiting discrimination among tendering shareholders as well as provisions permitting investors sufficient delays in making their investment decision[53].

Perhaps the most significant departure from the Williams Act is the requirement outlined in sections 94 to 99 of the OSA pursuant to which an offeror who becomes the owner of more than 20% of the target's voting securities through private agreement with more than five

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50. Veasey, Bodnar & Bennet, The Growing Complexity of the Business Judgment Rule, in 19th Annual Institute on Securities Regulation (PLI 1982), 93.
51. Anisman, Proposals for a Securities Market for Canada: Purpose and Process, 19 Osgoode Hall L.J. 329 (1981), 331.
52. See OSA, sections 99 and 94(1).
53. Sections 94(2) and 94(3) allow for a minimum deposit period of 21 days during which time no securities will be taken up. Section 94(7) provides for pro-rata take-up when the bid is made for less than all of the class of targeted securities.

sellers and has paid a premium of at least 15% over the market price of those securities is obliged to make a follow-up offer equal to the highest consideration or cash equivalent of such consideration to the target's remaining shareholders[54]. The followup offer requirements do not apply to partial bids nor to bids made through the facilities of the Toronto Stock Exchange[55]. As DeMott has stated:

> «the Ontario approach results in a more integrated treatment of separate transaction that may shift control in the target company because it requires acquisitions that would give the purchaser a sizeable (i.e. 20%) holding to be made through a general all holders offer; it further achieves equal treatment of target shareholders if the transaction shifting control results from purchase from a few presumably large stockholders»[56].

One striking factor in examining Directors' responsibilities in the context of a hostile takeover in Canada is the paucity of appropriate case law. Presumably, this fact can be partially attributed to the more detailed rules regulating takeover bids, particularly with respect to the compulsory follow-up offer and the compulsory acquisition provisions contained in the various corporate and securities statutes[57]. While there is no shortage of literature outlining the duties of Directors of Canadian corporations in general[58], the development of governing principles in evaluating and determining Directors' duties in the context of a hostile takeover is still in its embryonic stage.

In the Anglo-Canadian setting, the protection generally accorded to Directors in the exercise of their functions can be traced as far back as to the early British case of Charitable Corporation v.

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54. See, generally, J. Courtright, Securities Regulation of Takeover Bids in Canada (1985) and De Mott, Comparative Dimensions in Takeover Regulation, in Knights, Raiders, and Targets: The Impact of the Hostile Takeover, (1988), 398.
55. OSA, section 92.
56. De Mott, supra note 54, at 412.
57. Howard, supra note 15, at 60.
58. See, generally, M. Ross, Canadian Corporate Directors on the Firing Line, (1980), Howard, Directors and Officers in the Context of the Canada Business Corporations Act in Meredith Memorial Lectures, (1975) and M. Ellis, Fiduciary Duties in Canadaɗ¢εħɦɦχʤ

Sutton[59]. As stated by the court, the law will not interfere with decisions taken within the parameters of the Directors' normal corporate duties except that they must be conducted with reasonable faith and fidelity[60]. The court's reluctance to second guess the wisdom of Directors' business judgment only applies when decisions are taken in good faith, in the belief that they are in the company's best interests[61]. Although not specifically labelled «the business judgment rule», the scope of judicial evaluation is almost identical to what is applied by American courts in evaluating Board decisions outside of the takeover environment. A much stricter standard of duty of loyalty (fiduciary duty) applies in transactions involving the usurping of corporate opportunity[62] as well as in other situations of conflict of interest[63].

In the context of a hostile takeover, the leading Canadian case is Teck Corporation v. Millar et. al.[64] In this case, the Directors of Afton Corporation, a mining company, contrary to the wishes of Teck Corporation, the plaintiff controlling shareholder, entered into a mining exploration and development agreement with a third party pursuant to which this third party acquired the right to receive shares equal to 30% of all the outstanding shares of Afton. The issuance of the shares was contingent upon the Afton mine being brought into production. The agreement had the dual effect of excluding Teck from directly participating in the development of the mine (one of the reasons why Teck had acquired control in the first place) as well as severely diluting Teck's control position.

In examining the Directors' actions, the court had to determine whether the issuance of the shares was for an improper purpose, and therefore constituted an abuse of power[65]. Teck's argument was based on the principle set forth in the British case Hogg v. Cramphorn Ltd.[66] that the Directors have no right to exercise their power to issue shares in order to defeat an attempt to secure control of the company even if they consider that in so doing they are acting in the company's best

59. (1797), 26 E.R. 642.
60. Ellis, supra note 58, at 15-2.
61. F. Iacobucci, M. Pilkington & R. Prichard, Canadian Business Corporations, (1977), 294-295.
62. See, e.g., Canadian Aero Service Ltd. v. O'Malley, 40 D.L.R. 3d (1973) 371 S.C.C.
63. Howard, supra note 58, at 296.
64. 33 D.L.R. 3d (1973) 288 S.C.B.C.
65. Id., at 309.
66. (1966) 3 All E.R. 420.

interests[67]. The implication is that the issuance of shares merely to retain control is an improper purpose and consequently a breach of fiduciary duty. The British Columbia court rejected this argument and stated that:

> «directors are entitled to consider the reputation, experience and policies of anyone seeking to take over the company. If they decide, on reasonable grounds, a takeover will cause substantial damage to the company's interests, they are entitled to use their powers to protect the company»[68].

The court then examined the Directors' motivation in making their decision and determined that their primary objective was not to retain control of the company, but rather, to get the best possible agreement in order to develop the mine efficiently and profitably[69]. The Directors, acting in the best interests of the shareholders, did not breach their fiduciary duties even though they may have also benefitted as a result[70].

The principles elicited in Teck have been reaffirmed in several other Canadian cases including Re Royal Trust Co. Ltd. No. 3[71] and First City Financial Corp. Ltd. v. Genstar Corp.[72] In this latter case, the target company, responding to First City's surprise takeover attempt, sought out a white knight, Genstar, and proceeded to: a) grant to Genstar an option to acquire 10% of its outstanding shares; and b) file a preliminary prospectus to issue new shares. In denying a motion for an interlocutory judgment, the Ontario Supreme Court expressed its reluctance to interfere in matters which lie within the ambit of securities regulation[73]. With regard to the breach of fiduciary duty, the court stated that:

> «directors have the right and indeed the obligation to take steps they honestly and reasonably believe are in the

67. Teck Corp. v. Millar, 33 D.L.R. 3d (1973) 288 S.C.B.C., at 311.
68. Id., at 317.
69. Id., at 330.
70. Ibid.
71. 14 B.L.R. 307 (Ont. S.C. 1981).
72. 15 B.L.R. 60 (Ont. S.C. 1981).
73. Id., at 76.

> interests of the company and its shareholders in a takeover contest»[74].

The court went on to say that evaluating the proper course of action for the Board would require a careful look at all of the circumstances, particularly the Directors' motives, and conceded that this would be very difficult to do on an interlocutory motion[75].

In more recent case law, the Nova Scotia Supreme Court was called upon to adjudicate a multitude of issues in the takeover battle for the Nova Scotia Savings & Loan Company[76]. Among the issues in question was the actions of the Board of Directors of the target which, while vigorously opposing the takeover attempt authorized: a) the creation of an employee stock option plan to which the Directors were the main beneficiaries; and b) the issuance of additional shares to friendly suitors.

Relying largely on the business purpose doctrine or proper purpose doctrine set forth in Teck, the court stated:

> «When exercising their power to issue shares from treasury the Directors must be able to show that the considerations upon which the decision to issue was based are consistent only with the best interests of the company and inconsistent with any other interests. This burden ought be on the Directors once a treasury issue has been challenged»[77].

Given the set of circumstances surrounding the issuance, the court concluded that the Directors had breached their fiduciary duties in making a one-sided allotment of shares for the purposes of watering down the holdings of the unwanted raider. In supporting another group which was «not unfriendly» to present management, the Board used its

74. Id., at 80.
75. Ibid.
76. Exco Corporation et. al. v. Nova Scotia Savings & Loan Company et. al. 35 B.L.R. 149 (N.S.S.C. 1978).
77. Id., at 261

power for a purpose which was not demonstratably in the best interests of the company[78].

The preceding cases have primarily involved the issuance of additional shares as a defensive tactic however this is only one of the measures which can be taken by the Directors of a target company in order to ward off an unwanted suitor[79]. Other measures remain either untried or untested before the court. Recently however, a sale of the crown jewels of the target corporation has been th object of a series of court proceedings collectively referred to as Re Olympia & York Enterprises Ltd. and Hiram Walker Resources Ltd. et al[80] The questionable transaction involved the sale by Hiram, the target of a hostile takeover bid by Gulf Canada Corporation (a company controlled by Olympia & York), of its distiller business to a third party. Among the issues before the court was whether the sale represented an improper use of the target's assets by the Board contrary to their fiduciary duties[81]. Citing the Teck case as the proper test to be applied, namely, whether the Directors honestly and reasonably believed that what they were doing was in the best interests of the corporation and they did not have as their primary purpose the entrenching of management, the court was satisfied that the Directors had not breached their duties. The court's conclusion was based on the fact that the Board had acted in accordance with their professional advice and because the proceeds of the sale were to be used for an eventual offer to the shareholders[82]. As Simmonds points out, there was not a very close examination of the appropriateness of the tactics chosen by the Directors as the recent American caselaw would suggest[83].

Most recently, Inco Ltd., a Toronto based nickel producer, was the first Canadian corporation to adopt a poison pill[84]. The Board of Directors of Inco, well aware of the attractiveness of the corporation due to its record earnings and surplus cash, proposed a special $10 per share dividend as well as the adoption of the poison pill in the form of

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78. Id., at 262
79. See, generally, Horn, Takeover Bid Defenses in the Province of Quebec, 22 McGill L.J. 263 (1976); Yake, Comparative Takeover Tactics, 2 Cdn - Amer. L.J. 43 (1983); and Iacobucci, Planning and Implementing Defenses to Takeover Bids: The Directors' Role, 5 Cdn. Bus. L.J. 131 (1980-81).
80. (1986) 59 O.R. (2d) 254. See Simmonds, Note, Cdn. Bar R. (1987), 626.
81. Simmonds, supra note 80, at 628
82. Id., at 630.
83. Id., at 630-631. Simmonds cites the Revlon case, 506 A.2d 173 (S.C. Del, 1986), as an example where there was greater willingness by the courts to go beyond the traditional judicial restraint commonly associated with the business judgment rule.
84. Wall St. J. Oct. 4, 1988, at A4, col. 1.

a rights plan[85]. The plan, which was effective immediately, along with the special dividend, were to be submitted to the shareholders for approval. Shortly after the announcement, the Caisse de dépôt et placement, one of Canada's largest institutional investors, filed an action to keep Inco from adopting the plan[86] and it remains to be seen what the courts' reaction may be.

This brief survey of Canadian caselaw indicates that while still very much in its development stage, the Canadian courts have moved somewhat beyond the normal level of review associated with the business judgment doctrine in their evaluation of Directors' decisions, however the two-step test consecrated in Unocal and regularly applied since has yet to be acknowledged. The reasons why the standards of evaluation as applied by the courts may differ is the subject of the following section.

Part III

When comparing any two systems of law, there is always the danger of failing to distinguish between the forest and the trees. Cultural, social, economic and historical differences must be considered in order to properly assess the present state of affairs. Fortunately, in the Canadian-American context, these differences are minimal given the common background, geographical proximity and long-standing close commercial relationship between the two countries. With respect to corporate law in general and securities and takeover legislation in particular, the differences are even less pronounced given each system's common British origin and the fact that, to a great extent, Canadian corporate law is modeled after New York law[87].

The fundamental goals of both American and Canadian takeover legislation are similar; each attempts to: a) ensure that target shareholders are furnished with adequate information; b) ensure that each shareholder has an equal opportunity to consider the offer and then decide to accept it or reject it; c) permit an equal sharing of the consideration offered; and d) maintain an equal balance between those who seek to take over the target and those who seek to defend it[88]. As

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85. Ibid.
86. Wall St. J. Oct. 7, 1988, at C12, col. 5.
87. Howard, supra note 58, at 284.
88. Flisfeder, Comparative Aspects of Corporate Take-Overs in Anglo-Canadian and American Law, unpublished thesis, McGill University Institute of Comparative Law (1971), 192.

discussed, neither country's securities laws expressly attempt to regulate the fairness of corporate control transactions.

Similarities in legislative content is not limited to the regulation of takeovers. The various provisions outlining Directors, duties found in the American state and Canadian provincial corporate statutes are also quite similar, reinforcing the view that Directors of Canadian corporations face the same standards of judicial scrutiny as do their American counterparts in evaluating their responses to a hostile takeover. While this view is fundamentally correct, there exists several important distinctions which warrant further investigation.

One feature of Canadian takeover legislation which cannot be overlooked is the follow-up requirement[89]. This requirement prevents a raider from buying a control block at a premium in a nontender offer situation and then proceeding with a second step freeze-out merger. It has been in response to this type of transaction, or the threat thereof, that the American courts have upheld the more drastic takeover defense tactics[90]. Since the reasonableness of the defensive tactic employed is directly related to the perception of the threat posed, this test would have to be employed in a different manner in Canada given that coercive, two step, front-end loaded, takeover bids are not possible. If all shareholders have the right to receive equal consideration[91] then Canadian courts may be more inclined to examine the threat to the target's continued existence or perhaps the possible threat to the corporation's other constituents, namely its employees, creditors, customers and community. This notion of extended

89. See text accompanying notes 54-56, supra.

90. See, e.g., Unocal v. Mesa Petroleum 493 A.2d 946, 955 (Del. 1985), where a discriminatory self-tender offer was upheld; Moran v. Household International Inc. 500 A.2d 1346 (S.C. Del. 1985), where a poison pill was upheld; and Ivanhoe Partners v. Newmont Mining Corp. 535 A.2d 1334 (S.C. Del. 1987), where a street sweep facilitated by the payment of a large dividend was upheld.

91. See, e.g., e Royal Trustco Ltd. and Campeau Corporation No. 2, 11 B.L.R. 298 (Ont. Sec. Comm. 1980) where it was determined that a collateral agreement with a controlling shareholder of the target provided for more favourable consideration. The Ontario Securities Commission issued a cease trading order until such time that the Commission received acknowledgements and agreements that the controlling shareholder would not receive additional consideration.

Directors' duty remains an unresolved question in both the United States[92] and Canada[93].

There is also a fundamental difference between Canadian and American corporate statutes in that in Canada the fiduciary duty of Directors is owed to the Corporation and not expressly to its shareholders[94]. Although this nuance could conceivably allow Directors of Canadian corporations to consider factors other than the maximization of shareholder value in evaluating and developing strategy in defending against a hostile takeover, this view was not accepted in the recent Olympia York case[95]. As Canadian caselaw develops, this distinction may also be used to support the notion of an extended Directors' duty as noted above.

Another distinction is that Canadian corporate statutes place more constraints on Directors' discretion as illustrated by the respective division of power between directors and shareholders. In Canada there is a much greater emphasis placed on shareholder suffrage and, depending on whether they constitute a «fundamental change», certain takeover defenses may require shareholder approval as a pre-condition to their validity[96]. For instance, a «scorched earth» defense or «crown jewel lock-up» may constitute a sale of «all or substantially all of the property of the corporation» in which case shareholder approval would be required[97].

Mitigating somewhat the more onerous Canadian requirement for greater shareholder participation is the greater ease in Canada in communicating with shareholders. Proxy materials, which in the United States have to be pre-cleared with the Securities and Exchange Commission[98], can be sent without pre-clearance by Canadian target companies. This, of course, speeds up the time frame in which the

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92. See, e.g., Unocal v. Mesa Petroleum 493 A.2d 946, at 955 where the consideration of other corporate constituents was permitted; but contra Revlon, Inc. v. MacAndrew and Forbes Holdings, Inc. 506 A.2d 173 (S.C. Del., 1986), at 182 where this view was rejected.
93. See, e.g., Iacobucci, supra note 79, at 163-164. The author states that the traditional view that directors are to act in the interests of the corporation, that is, shareholders as a whole, and not in the interests of consumers, employees or the nation is beginning to show signs of age.
94. Turner, Fiduciary Duties in the Friendly Take-Over or The Auction and How Not to Run One, in Insight Conference on Anatomy of a Friendly Take-Over, May 1989, 9.
95. (1986) 59 O.R. (2d) 254, at 271.
96. See, e.g., Section 167 C.B.C.A.
97. This issue was raised in the Olympia York case, (1986) 59 O.R. (2d) 254.
98. Rule 14a-6 under Securities and Exchange Act.

Board of Directors may call a shareholders' meeting and thus encourages Directors to seek shareholder approval of takeover defenses, particularly those which are anticipatory rather than remedial[99]. Shareholder approval of a particular defensive tactic, such as the issuance of shares, sale of a division, granting of an option or the creation of a right's plan, while normally the prerogatives of the Board, may preclude the courts from reviewing the reasonableness of these measures, therefore relieving Directors from possible liability[100].

To some extent, Directors of Canadian corporations have much greater freedom in issuing and allotting new shares. Most provincial corporate statutes and the CBCA permit an unlimited authorized share capital[101]. Although the creation and issuance of additional shares does not normally entail charter amendments and the requisite shareholder approval, all of the major stock exchanges in Canada require prior notice when treasury securities or options to purchase treasury securities are to be issued and the exchanges maintain the right to require shareholder approval in order to list these shares[102]. As discussed in the preceding section, the Board's discretion to issue additional shares is often the gravaman of Canadian takeover litigation so while it can be said that Directors of Canadian corporations have easier access to this defense, their discretion will be constrained by the «proper purpose» test set forth in Teck.

There exist, of course, many other distinctions which have some effect on the takeover environment in general and thus impact on Directors' responsibilities, most of which are beyond the scope of this paper. It is clear however that: a) takeover procedures are more clearly defined in Canada; and b) in the absence of shareholder approval, the range of available takeover defenses is much more limited in Canada. Given these assumptions, Canadian courts are more likely to engage in a more stringent review of Directors' adoption of takeover tactics without shareholder approval. The proper purpose test enunciated in Teck and used in evaluating the issuance of shares involved not only the examination of the independence of the Board of Directors and the absence of self-dealing, fraud and abuse but a conjecture as to the motives of the Board as well. While not

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99. See, e.g., L. Lowenstein, What's Wrong with Wall Street, (1988) 178-179 where the author makes his point in reference to the British system.
100. See Iacobucci, supra note 79, at 163-164. The author admits that is difficult to articulate a rule as to when and in what circumstances the courts will recognize shareholder ratification.
101. CBCA, section 6 (1) (c).
102. De Mott, supra note 54, at 413-414.

inconsistent with the prevailing standard in the United States, it requires a greater degree of judicial review.

CONCLUSION

Despite some important differences between the two countries in the existing legal framework pertaining to takeovers and Directors' duties, the fundamental principles are essentially the same[103]. To some extent the differences in the evaluation of Directors' behavior in the context of a hostile takeover can be attributed to the fact that American caselaw is much more developed. It has had ample opportunity to grapple with the seemingly irreconcilable conflicts and distinguishing nuances in order to articulate a set of judicial guidelines flexible enough to allow for their application to a wide range and ever changing set of facts and circumstances.

The magnitude of judicial review of corporate control transactions in the United States is no accident as the dearth of substantive takeover legislation has left it up to the courts to determine what is fair in the making of and the defending against a hostile takeover. Canada, on the other hand, has chosen a more stringent regulatory process and, while avoiding the imposition of substantive fairness tests, has established more concrete procedures to ensure that all shareholders are treated equally.

An equally important factor in the development of judicial interpretation of Directors' duties in the course of a hostile takeover is the dominant trend in Canada towards friendly takeovers. As certain authors[104] have pointed out, the high degree of corporate concentration in Canada dictates that corporate control transactions are more often negotiated rather than initiated as a hostile takeover bid. While this factor may not affect Directors' duties per se, it has had the effect of contributing to the under-development of Canadian caselaw on the subject.

The extensive role of the judiciary in the United States is both a feature and a by-product of its society. The much larger population and capital base make it economically feasible for plaintiffs to institute litigation against corporate Directors. Access to the courts is further

103. Flisfeder, supra note 88.
104. See, e.g., Turner, supra note 94, at 1. De Mott, supra note 54, at 400, also notes the high degree of shareholders' concentration but does not conclude that this is a factor contributing to the predominance of friendly takeovers in Canada.

facilitated by the ease in certifying a group of shareholders for class action and the more acceptable practice of contingency fees for lawyers[105]. In the United States, damages for breaches of Directors' duties during a hostile takeover, being a function of the number of outstanding shares and the premium offered, can run into the tens of millions of dollars, thus providing the financial impetus for shareholders (and their lawyers) to take action. In Canada, where market capitalization is much less, and class action certification for shareholders more difficult, government, rather than the private citizen has assumed the watchdog role.

Historically, government in Canada has assumed a much greater role in regulating many facets of economic activity and there is little reason to assume that this would be any less apparent in the regulation of takeovers. It will be interesting to see whether the recently promulgated free trade arrangement between the two countries will instigate a harmonization of the legislative framework and judicial scrutiny of takeovers in order to ensure that substantial barriers do not exist which might otherwise impede the free-flow of capital.

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105. Frazier, The Regulations of Takeovers in Britain in Knights, Raiders and Targets, supra note 54, at 437.