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E-BRIEF

November 10, 2016

FINANCIAL SERVICES AND REGULATION

Takeover Rules: In Support of the Longer Minimum Bid Period

by

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- Securities regulators made the right move this year when they extended the minimum bid period for takeover bids in Canada. This should help level the playing field between bidders and the target by strengthening the board's role and, therefore, increasing the likelihood that a successful takeover bid will maximize value for the target's shareholders.
- As experience is gained under the new rules, securities regulators should monitor their effect on the number of both hostile bids and negotiated control transactions, and the relative benefits shareholders receive in the two scenarios. Regulators should also measure the broader economic effect of the new rules on the size and competitive position of Canadian-based public companies and capital markets.

On May 9, 2016, the Canadian securities regulators adopted new takeover bid rules that, among other things, extended the minimum bid period from 35 to 105 days. Regulators implemented the new rules after a long period of extensive debate about the impact of hostile bids and whether a target's shareholders or its board should decide the outcome of such bids. The choice of 105 days reflects a compromise: it gives boards more time, but it does not allow them to "just say no." Good

The author has benefited significantly from discussing these matters with the other members of the Ad Hoc Group of Securities Practitioners (William Braithwaite, Clay Horner, Jeffrey Lloyd, Garth Girvan, Vincent Mercier, Stephen Halperin and Ed Waitzer) who submitted comments on an earlier proposal by the Canadian Securities Administrators, as well as with her colleagues at Torys LLP, particularly Richard Balfour and James Tory. She also benefited from the comments provided on this E-Brief by Ed Waitzer, Anita Anand and anonymous reviewers.

corporate governance requires a more nuanced approach. Giving boards a longer period to respond to hostile bids forges a sensible middle ground between competing positions. A longer minimum bid period should help level the playing field between bidders and the target by strengthening the board's role and, therefore, increasing the likelihood that a successful takeover bid will maximize value for the target's shareholders.

Dealing with the Control Premium

There is nothing in the new rules – or in a shareholder rights plan, for that matter – that prevents individual shareholders from selling their shares whenever they choose. In a takeover bid, however, the bidder is also seeking to acquire control. If the bid succeeds, shareholders will not only have dealt with their own investments; they will also have collectively sold the control premium. It is the sale of the control premium that the rules address and restrict.

Individual shareholders generally cannot maximize the control premium or ensure that they participate in the premium at all. The new takeover bid rules address the latter concern by requiring a bidder for control to extend its offer to all shareholders equally and by imposing restrictions such as the minimum bid period to prevent coercive bids. The new rules strengthen the protections against coercive bids by adding a minimum 50 percent tender condition and an automatic 10-day extension requirement. However, the new 105-day minimum bid period goes further, by giving boards a longer period to exercise their fiduciary duty to act in their company's best interests and to protect shareholders and other stakeholders against less than optimal transactions.

The Minimum Bid Period Is about Empowering the Target Board to Negotiate

I do not believe that boards of targets should be able simply to veto hostile bids. But I do believe that boards have a critical role to play in responding to hostile bids, and that the previous securities regulatory regime undermined their ability to play that role effectively. The new rules represent a better balance in this respect.

The shareholders of a publicly listed company typically are dispersed, transient and subject to informational disadvantage. Unlike directors, shareholders are not subject to fiduciary obligations, nor is there any guarantee that their interests will align with those of other shareholders or stakeholders.[1] Rather, they are motivated to act in their own self-interest, based on their own unique investment objectives. That is a perfectly acceptable motive, and I do not suggest that a fiduciary obligation to other investors be imposed on them. However, the timing and price at which the control premium is sold ideally should be determined by what is in the best interests of the company and its shareholders collectively.

Those who argue against board intervention in the bid context quote National Policy 62-202 on Defensive Tactics, which states that "unrestricted auctions produce the most desirable results in take-over situations." Auctions, however, are restricted by their nature – that is why they work. Auctions require bidders to deal with a single auctioneer in a controlled setting. In an auction for control of a widely held, publicly traded company, shareholders cannot bargain collectively except through the board. The fact that holders of a majority of the

1 A well-known example occurred in the bid by AbitibiBowater Inc. for Fibrek Inc., which was supported by shareholders of the target who had a larger economic interest in the bidder than in the target.

shares support a transaction does not mean that it is the best transaction they could have achieved had they been able to negotiate collectively. By contrast, the board has full information regarding the company's business, risks and outlook, is in a better position to deal with regulatory and other barriers that prevent or inhibit value-maximizing offers and can act as the focal point for receiving bids, negotiating their terms and deciding which to take to shareholders for approval.

Auction rules also permit the seller to determine the timing of the sale, to invite the right participants and to remove the target from the market if a satisfactory price is not obtained. Without the ability to reject an offer, a seller has no leverage. To maximize the control premium, a target board needs these same tools.

The Threat of Board Entrenchment

It is true that directors face a potential conflict of interest in considering an offer for control, because they likely will lose their position if it is successful. They also might attempt to extract personal benefits as a condition of supporting a transaction. Canada's corporate governance model, however, rests on boards' doing their jobs and avoiding those conflicts. Distrust of directors' motives should not be addressed by disarming them, but by insisting that they do their jobs well.

Corporate governance improvements in recent years have resulted in more professional directors, who, among other things, focus on conflict management. The growth of shareholder activism and the threat of litigation have made boards extremely attentive to shareholders' interests. The new rules might have placed boards in a better position to resist a hostile bid, but they cannot prevent a proxy battle to replace a board. Reputations are also at stake. Directors must defend their decisions before the shareholders who elect them each year, and they must disclose the benefits they receive in their role and as part of any change of control transaction. Majority voting policies and the requirement to publish the results of individual directors' votes have made boards even less likely to ignore this constituency. In my experience advising target boards, shareholders' interests are rightly the key drivers of their decision-making in the merger context; directors generally recognize that they cannot focus on retaining their board seats.

Instead of limiting the board's ability to do its job when faced with a takeover bid, shareholders should use the legal and practical tools at their disposal to press for better board governance and to hold directors to account if they fail to fulfil their responsibilities.

Why 105 Days?

There is no magic in the 105-day period: it was arrived at as a compromise, and is designed to balance a number of objectives.

First, the previous 35-day statutory minimum was largely irrelevant given the prevalence of shareholders' rights plans or "poison pills." Securities regulators typically allowed those plans to remain in place for at least 45 to 60 days. Bid periods of that duration or longer were common, and bidders and their financing parties were able to manage those longer periods. The bid period was determined, however, on an ad hoc basis by panels of securities regulators who were being asked to second-guess boards' business judgment while applying inconsistent poison pill jurisprudence. That process invariably resulted in a minimum bid period that significantly exceeded 35 days but was highly uncertain. The real choice before the Canadian Securities Administrators was not between 35 days and 105 days, but between an uncertain minimum period of substantially longer than 35 days and a minimum period that could be both consistently applied and long enough to remove justifications for defensive tactics intended to lengthen the bid period. Although costs to bidders are associated with the longer minimum period, there should also be less scope for defensive tactics, as well as benefits to bidders from eliminating the uncertainty of the previous regime.

Second, having advised boards of buyers and targets in good markets and bad, it is clear to me that the previous period did not strike the right balance. Even when a target decided to explore strategic options on its own initiative, the process typically would run for a few months or more, depending on the complexity of the business. Contrast that situation with a target confronted by an unexpected hostile bid. It is common for unsolicited bids to be timed opportunistically, when shareholders might accept a lower price that does not reflect the company's long-term value. Bidders often increase the pressure by launching their bid when the target management is distracted or not well-positioned to mount a defence. In that context, the target needs much longer to respond if it wants to launch a sale process to find a better deal for its shareholders. It must hire advisors, establish a data room and structure the process. Competing bidders need to form working teams, conduct diligence, arrange financing and negotiate terms. The previous minimum bid period, even when extended by implementing a shareholders' rights plan, was often insufficient to achieve an optimal sale process.

The choice of 105 days is not based solely on how much time is necessary for a competing bid to emerge, which I recognize might be a shorter period,[2] but it does address the more fundamental need to give target boards some leverage. A board cannot negotiate with a bidder that knows that, in 35 days – or 60 or 90 – it can force a decision by a dispersed shareholder base. I agree that forcing a bidder to leave its offer outstanding for longer increases the bidder's risk, deters hostile bids and, therefore, potentially insulates boards from the discipline that a potential bid for control creates. The key benefit of the longer period, however, is that it encourages bidders to work with the target board to shorten the bid period. Ultimately, this should drive bidders into the auction process, and give the target board a fighting chance to extract the best possible result for its shareholders.

As experience is gained under the new rules, securities regulators should monitor their effect on the number of both hostile bids and negotiated control transactions, and the relative benefits shareholders receive in the two scenarios. Regulators should also measure the broader economic effect of the new rules on the size and competitive position of Canadian-based public companies and capital markets. Securities laws should not foster short-term price gains; rather, they should promote strong public companies and capital markets that deliver long-term economic value to investors. That outcome will require strong management endowed with reasonable flexibility to implement strategies for long-term growth. Increasing the minimum bid period is a positive step in that direction.

2 A recent study finds that, where a competing bid was generated after a hostile bid, it took an average of 41 days for the competing bid to emerge, and that the vast majority of competing bids were generated in less than 95 days. However, the study also finds that, for approximately 38 percent of hostile bids, no competing bid emerged at all, and that the average premium to shareholders where a hostile bid did face competition was 76 percent compared with 45 percent for those where it did not. Moreover, targets with shareholders' rights plans generated competing bids twice as often as those without. See Aaron J. Atkinson and Bradley A. Freelan, *2015 Canadian Hostile Take-Over Bid Study* (Toronto: Fasken Martineau DuMoulin LLP, 2015).

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This E-Brief is a publication of the C.D. Howe Institute.

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