HOSTILE TAKEOVERS AND CORPORATE PURPOSE: THE ROLE OF POISON PILLS IN ONTARIO SECURITIES LAW

BY

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This paper examines the Ontario Securities Commission's regulation of poison pills as well as several proposals to reform the current regulatory regime. In particular, the paper argues that regulation and reforms should be viewed within the context of two fundamental, normative questions that underlie much of corporate law: what is the purpose of the corporation, and who should determine whether these goals are being met. After outlining several competing theories, the paper explains why a corporate model based on the shareholder-centric, wealth maximization theory is best suited for hostile takeover situations. Additionally, the paper argues that a structural bid reform that would require hostile bidders to include minimum tender conditions and additional opportunities for target company shareholders to tender following a successful bid would provide the best way to incorporate this corporate model into Ontario securities regulation.
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I. INTRODUCTION

Shareholder Rights Plans (also referred to as "poison pills"), which were initially developed in the United States in response to a wave of hostile takeovers in U.S. markets, have proved an effective mechanism for preventing unfriendly acquisitions through a hostile takeover bid. Upon the hostile bidder acquiring a certain ownership percentage, poison pills allow directors of the target company to significantly dilute the ownership percentage of the hostile bidder by issuing new shares at a discounted rate to all shareholders but the bidder. But poison pills have been controversial since their adoption, and scholars have long debated their relative worth.¹ Given the draft Shareholder Rights Plan ("poison pill") rule recently proposed by the Canadian Securities Administrators, as well as an alternate proposal offered by the Quebec Autorité des marchés financiers ("AMF"), renewed discussion regarding the respective benefits of new poison pill regulation is timely.

However, before delving into the topic, a threshold inquiry is required: one must understand the underlying values and assumptions that shape views regarding the best way to regulate a target company's defensive responses to a hostile takeover bid. Generally, this inquiry can be broken down into two underlying normative questions, which this thesis aims to address. The first, and most fundamental, question is as follows: what is the purpose of the corporation? Part II considers this question, highlighting the answers that three theories - the aggregate private property theory, the wealth maximization theory, and the community actor theory - provide. The second question, which flows from the first, concerns the role of corporate participants during a hostile takeover. In particular, the second question asks: who

should determine whether the goals of a corporation are being met, and whether the takeover is the best method for meeting them? Part III analyzes this second question from the perspective of the two dominant theories in Canadian law - the wealth maximization theory and the community actor theory.

Once these fundamental questions have been addressed, Part IV considers their application to the Ontario Securities Commission ("Commission"), the entity primarily responsible for poison pill oversight in the province of Ontario. In particular, this Part considers the underlying wealth maximization, shareholder primacy model that is reflected in the goals of the Ontario Securities Act ("OSA"), as well as the constraints that these goals place on the range of regulation that the Commission can implement. The Part also considers how the Commission has interpreted the goals of the OSA and put them into practice through its regulatory actions, including through its adoption of National Policy 62-202 and its poison pill jurisprudence. Part V next considers reforms. The Part first discusses several suggested reforms - reliance on market mechanisms, independent director approval of poison pills, and shareholder approval requirements - and discusses the problems with each of these potential reforms from the shareholder primacy, wealth maximization model adopted by the OSA. The Part also offers an alternative proposal - the structural permitted bid - that could better meet the respective goals of the OSA as well as avoid some of the practical problems that confront other proposals. In the alternative, the Part discusses the problems with moving towards stakeholder-focused poison pill regulation, as some scholars have suggested. Lastly, Part VI concludes.
II. **What is the Purpose of the Corporation?**

In determining whether a defensive response to a hostile takeover is good or bad, underlying normative views regarding the purpose of the corporation can affect one's answer. In the context of poison pills, three theories of the corporation are particularly relevant: the aggregated private property theory, the wealth maximization theory, and the community actor theory. The latter two theories are by far the most dominant. They underlie much of the modern scholarship regarding poison pills and provide the theoretical underpinnings for securities and corporate law. However, the aggregated private property theory, while often disregarded by modern corporate scholarship, continues to surface surreptitiously in arguments in favor of poison pills.

A. **Corporation as Aggregated Private Property**

According to the aggregated property theory, the corporation is not an entity in itself, but is merely an aggregation of individual property, similar to a partnership or other collective endeavor.\(^2\) As such, shareholders are owners of the percentage of the corporation represented by the shares of the corporation that they hold. As owners, shareholders are entitled to actively manage their property interest, decide how they want to exercise their ownership rights, and determine when they wish to dispose of their property.\(^3\) Additionally, the aggregated private property theory advocates that shareholders be given unconstrained discretion to determine the price and conditions at which they will sell their shares.\(^4\) In other words, shareholders should be permitted to sell their shares at any price they can negotiate,

\(^4\) See Nicholls, *supra* note 3 at 169.
free from unwanted legislative or managerial interference. But the theory does envision a role for management, provided that any directive comes from shareholders. For instance, shareholders could use management as a collective bargaining unit to ensure that they extract a higher price from any potential buyer.

However, the importance of the aggregated private property theory has diminished in recent corporate law scholarship. First, the increasing complexity and size, and the diversified share structure of most modern public corporations has influenced conceptions regarding the nature of shareholders' interest in the corporation. To quote one corporate scholar, the paradigm of shareholders has shifted from "entrepreneurs into passive investors who placed their economic interests in the hands of professional managers." In addition, changes in the structure and operation of modern public corporations have caused some scholars to challenge the premise that shareholders "own" the corporation. The evolving nature of the corporation has thus resulted in a corresponding evolution in the dominant theories of corporate law, including a shift in the conceptualization of shareholders' roles in the corporation.

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8 See Lynn A. Stout, "Bad and Not-So-Bad Arguments for Shareholder Primacy" (2002) 75 S. Cal. L. Rev. 1189 at 1190-92 (questioning whether shareholders can be said to "own" a public corporation when equity holders and bondholders jointly bear residual risk and share contingent control of the corporation).
9 For instance, under the wealth maximization theory, shareholders are primarily instrumental, and their preferences are important to the extent that they increase efficiency and corporate wealth. Under the community actor model, shareholders remain important
But while many modern legal scholars have challenged the aggregated private property rights theory, elements of it continue to exert some residual influence on corporate and securities law. For instance, concepts underlying the aggregated private property theory have continued to resurface as justification for certain uses of poison pills. For instance, some practitioners have argued that shareholders should be allowed to use management as a collective bargaining unit to negotiate for a higher bid price. In such case, management would be permitted to deploy a pill as part of the shareholder-approved negotiation strategy.

B. Corporation as Wealth Maximizer

One of the dominant theories of modern corporate scholarship views corporations as agents of wealth maximization. According to the theory, the purpose of corporations is to generate the greatest level of global wealth, as measured by net economic value. The

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stakeholders whose preferences directors must consider, but they are joined by other stakeholders like debt holders and employees. See infra.

10 See e.g. Stout, supra note 8 at 1190-92.

11 See e.g. Vanderpol and Waitzer, supra note 6 (arguing that shareholders should be permitted to extract a greater percentage of control premiums through collective bargaining); Dey and Yalden, supra note 1 (arguing that poison pills enable shareholders to obtain a fair price for their shares).

12 But as will be discussed infra, this argument is problematic. Apart from the conceptual problems discussed above, the aggregated private property theory is in many ways inconsistent with the normative framework of the wealth maximization theory. This can create ideological inconsistencies when proponents adopt this argument while otherwise subscribing to the wealth maximization theory.

13 See Millon, supra note 2 at 222; MacIntosh, supra note 1.

14 See Jeffrey G. MacIntosh, "The End of Corporate Existence: Should Boards Act as Mediating Hierarchs? A Comment on Yalden" in Anita I. Anand and William F. Flanagan, eds., The Corporation in the 21st Century (Kingston: Queen's Annual Business Law Symposium, 2002) 37. While some scholars have tried to recast the theory by focusing on the corporation's ability to generate non-economic wealth, the standard conception of the theory focuses primarily on economic gains. Compare Einer Elhauge, "Sacrificing Corporate Profits in the Public Interest" (2005) 80 N.Y.U. L. Rev. 733 (arguing that corporate law should allow shareholders to determine their net welfare goals, whether economic or non-economic)
concept of efficiency is central to the theory: moving resources from less efficient uses to more efficient uses generates greater wealth. In this regard, two concepts of efficiency are important. The first focuses on whether a transaction can produce net wealth gains.\textsuperscript{15} This can be achieved in at least one of two ways. First, a transaction can be Pareto efficient if it makes some person or persons better off while making no person worse off as a result.\textsuperscript{16} Additionally, a transaction can be Kaldor-Hicks efficient if it generates sufficient welfare gains so that those gaining from the transaction could in theory fully compensate those who lost value as a result of the transaction and still retain benefits from the change.\textsuperscript{17}

The second conception of efficiency involves cost-benefit analysis, which weights the economic costs of any proposed action against its perceived economic benefits. For wealth maximization theorists, cost-benefit efficiency guides considerations regarding the preferred regulatory mechanism. To be cost-benefit efficient, corporate law should incorporate the least costly, least intrusive regulatory method available. Thus, in cases where regulation is required, cheaper and less burdensome methods would be favored over more intrusive ones. In the context of poison pills, cost-benefit efficiency would favor regulatory intervention only to the extent that it is not possible to guarantee fair and efficient treatment through market mechanisms. If regulation is necessary, cheaper and less burdensome methods should be favored over costlier, intrusive methods.

\textsuperscript{15} Michael Trebilcock, "Lessons and Limits of Law and Economics" in Pierre Nadeau, ed., \textit{In the Eye of the Beholder} (Montreal: Universite de Montreal, 2007) 115 at 133.

\textsuperscript{16} \textit{Ibid.}

\textsuperscript{17} \textit{Ibid.} at 133, 137.
Shareholders also occupy a central role in the standard wealth maximization theory, but for different reasons than the aggregated private property model. Proponents of the wealth maximization theory argue that directors and officers should seek to maximize shareholder value, as this provides the best way to increase net corporate value. But unlike the aggregate private property theory, which is primarily concerned with individual shareholder choice, the wealth maximization theory views shareholders instrumentally: while increasing shareholder wealth is important, the end goal of the wealth maximization theory is focused on increasing wealth system-wide, rather than for any particular set of shareholders. As a result, in some cases, the will of individual shareholders may be subverted for the sake of a wealth-maximizing transaction.

C. Corporation as Community Actor

While the wealth maximization theory endorses a single-minded focus on wealth generation, some scholars have argued that understandings of the corporation should be more nuanced. In a famous essay written early in the 20th century, E. Merrick Dodd argued against

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19 See Millon, supra note 2 at 215 (discussing gradual legislative abandonment of unanimous voting provisions with simple majority voting requirements in the context of de facto consolidations).

20 Some scholars have described similar theories as "pluralist", given their emphasis on the interests of multiple stakeholders. See e.g. Yalden, supra note 14 at 11. However, the term "community actor" is used here to clearly differentiate the theory from versions of the wealth maximization theory that adopt a similar stakeholder-centric approach.
construing the corporation solely as an agent of wealth-generation.21 Instead, Dodd argued that a corporation should be viewed as an economic institution that had profit-making as well as social service functions.22 In other words, a corporation's purpose is not just about achieving the greatest wealth, as reflected through its share price, but also acting as a responsible member of the community in which it belongs.23

While efficiency and wealth maximization remain the dominant paradigms of corporate law, there are some indications that the community actor model is gaining ground. At least one modern author has argued that recent large-scale corporate scandals and global recessions have caused many to rethink "the theoretical underpinnings of our current economic system and the rules of corporate law that facilitate it."24 Moreover, other common law jurisdictions have incorporated the community actor standard into their statutory fiduciary duties framework,25 and some scholars have argued that the Canadian Supreme Court has moved towards the community actor model in its recent decisions in Maple Leaf Foods Inc. v. Schneider Corp.26 and Peoples Department Stores Inc. (Trustee of) v. Wise.27

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21 See E. Merrick Dodd, Jr. "For Whom are Corporate Managers Trustees" (1932) 45 Harv. L. Rev. 1145.
22 Yalden, supra note 14 at 11.
23 Such a view is also arguably reflected in the Canadian Supreme Court's decision in BCE, which refers to the corporation's duties as a "responsible corporate citizen". See BCE Inc. v. 1976 Debentureholders, 2008 SCC 69 at para 82. See also Sarah Bradley, "BCE inc. v. 1976 Debentureholders, New Fiduciary Duties of Fair Treatment?" (2009) 41 Ottawa L.R. 325 at 344-48. For further discussion regarding the various elaborations of the theory, see Edward J. Waitzer and Johnny Jaswal, "Peoples, BCE and the Good Corporate 'Citizen' " (2009) 47 Osgoode Hall L.J. 439 at 471-75.
24 See Bradley, supra note 23 at 347.
25 See e.g. Companies Act 2006 (U.K.), 2006, c. 46, s.172(1) ("A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to... the impact of the company’s operations on the community and the environment[.]")
26 (1998), 42 OR (3d) 177; 44 BLR (2d) 115; 113 OAC 253.
Arguments for the community actor theory have been offered on several fronts. Professor Ian Lee, for instance, has argued for a more expansive understanding of corporate social responsibility based on a realist understanding of how markets function. According to Professor Lee, disparate economic and political power can create situations in which the normative framework of efficiency provides incomplete guidance for corporate directors. While Professor Lee acknowledges that a corporation is generally best suited to function based on the profit maximization framework, he argues that there are situations in which the effects of the corporation's actions on third-party interests are generally recognized and understood, but are not sufficiently represented by the profit-maximization framework. In such situations, he argues that it would not make sense to bind directors to the profit maximization model.

Other scholars have made arguments in favor of the community actor model based on the political nature of the modern corporation. For instance, some political economy scholars have argued that the political nature of the corporation and the involvement of the State in bringing it into being should be given the same weight as the private contractual negotiations that formed it. According to these scholars, the efficiency framework does not foreclose

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27 2004 SCC 68; Bradley, supra note 23 at 348 (mentioning similarities between the fiduciary duty standard in the Peoples and Maple Leaf decisions and the UK statutory framework).
28 Lee, supra note 18 at 576.
29 Lee, supra note 18 at 578 ("This may be especially likely to happen where the profit-maximizing course of action would severely impair or destroy important interests of third parties lacking in economic or political power.").
30 Ibid.
31 See Yalden supra note 14 at 13 n.33. According to Professor David Millon, elements of this argument underlie the decision of the Delaware Supreme Court in Paramount Communications v. Time, Inc., which addressed a target company board's decision to resist a hostile takeover despite the offer's apparent attractiveness to shareholders. Millon, supra note 2 at 252. In particular, Professor Millon notes that Justice Allen recognized that "preservation of the corporate enterprise's independence may be of public significance" to society as a
parallel conceptions of the corporation as a social institution or organization. While acknowledging that efficiency is important, they argue that other interests may also deserve consideration.\textsuperscript{32}

However, one important point should be made: most wealth maximization theorists also recognize the importance of protecting stakeholders from exploitation and achieving non-economic social goals.\textsuperscript{33} While the wealth maximization theory does not generally place social welfare considerations within the corporate decision-making process absent a profit-making motive, proponents of the wealth maximization model argue that more efficient utilization of corporate resources will increase overall wealth, which will result in more opportunities and benefits to stakeholders and society as a whole.\textsuperscript{34} The chief disagreement between wealth maximization theorists and community actor theorists instead revolves around the mechanism through which social welfare goals should be achieved. To proponents of the wealth-maximization theory, the wealth maximization theory provides a helpful process that maximizes economic as well as non-economic benefits. As communities determine what values should be prioritized, corporations provide the most efficient way to achieve that value through the wealth-maximization framework. In other words, rather than requiring a company to weigh social welfare considerations and stakeholder concerns, proponents argue that regulators should change the associated risks and costs of taking a given action, which will make it economically inefficient for a corporation to engage in an action that is not socially desirable. While the wealth maximization theory may create

\textsuperscript{32} Kelly and Parkinson, \textit{supra} note 18 at 123.
\textsuperscript{33} See e.g. MacIntosh, \textit{supra} note 14 at 75; Lee, \textit{supra} note 18 at 576.
\textsuperscript{34} Millon, \textit{supra} note 2 at 236.
distributional inequalities and the potential for exploitation of certain stakeholders, proponents argue that this can be addressed by modifying the external framework in which a company operates, rather than through modifying internal corporate governance mechanisms.

Wealth maximization theorists and community actor theorists also disagree on the effect that the stakeholder theory can have on corporate governance. While community actor theorists argue that the stakeholder-focused approach provides sufficient flexibility to address and balance different stakeholder interests, wealth maximization theorists criticize the model based on the amorphous standard that it imposes on corporate directors.\(^{35}\) Instead, these scholars argue that legislative intervention can achieve the same result - correcting distributional issues or concerns regarding the treatment of stakeholders - with lower enforcement costs and less risk of management entrenchment.\(^{36}\)

III. **Who Should Decide Whether the Corporate Purpose Is Being Fulfilled?**

In addition to determining the purpose of the corporation, it is important to determine who is best placed to make decisions as to its purpose when a hostile takeover looms. In this regard, the answer to the latter question often flows from the first. One's understanding of the purpose of the corporation, as well as certain assumptions regarding the nature of corporate actors and underlying efficiency of markets, can influence one's views regarding which entity should make the final decision. Parts A and B of this section discuss this question from the


\(^{36}\) See e.g. MacIntosh, *supra* note 14 at 75.
perspective of the two dominant theories in corporate law: wealth maximization and the community actor model.\textsuperscript{37} As each theory also envisions a unique role for external regulators, Part C explains and discusses these differences.

A. \textit{Wealth Maximization}

According to the wealth maximization theory, directors provide the most efficient governance structure for normal day-to-day business operations. In fact, this stance is incorporated into most corporate law regimes.\textsuperscript{38} But there is some disagreement among wealth maximization theorists as to whether directors should focus on shareholders' interests only or whether they should be permitted to consider the interests of a larger group of corporate stakeholders. As will be discussed, proponents of the shareholder primacy model and proponents of the stakeholder model of director management each claim that their respective model the best method for maximizing wealth.

Also considered is the role of directors during a hostile takeover. Wealth maximization theorists who subscribe to shareholder primacy generally argue that decisions regarding the fate of the company should shift from directors to shareholders in the face of a hostile bid. In other words, shareholders should be given the unrestricted ability to tender their shares to a hostile bidder. However, some wealth maximization theorists have argued that the shareholder primacy model should give more deference to directors during hostile takeovers, based on directors' access to information and the potential for shareholder coercion. Proponents of director deference argue that directors are better placed to determine

\textsuperscript{37} Given that the aggregated private property theory has greatly diminished in importance and only exerts a residual influence in modern corporate scholarship, it does not factor into the main part of this section's discussion.

\textsuperscript{38} For instance, under the 'business judgment rule' courts generally defer to directors' decisions provided that the directors were not self-interested, were informed, and followed the proper decision-making process.
the adequacy of an offer as they have access to information regarding the true value of the corporation. Additionally, proponents argue that shareholders may be subject to coercive takeover bids, which can result in shareholders making sub-optimal choices in aggregate. As will be discussed, the validity of these arguments depends on the level of efficiency that capital markets exhibit and the level of protection that corporate and securities laws provide against coercive bids.

1. Shareholder Primacy Model

Orthodox articulations of the wealth maximization theory generally adopt a shareholder primacy model, meaning that directors are required to consider shareholder wealth maximization when making decisions. Modern justifications for the shareholder primacy model are premised on the nexus of contracts theory, which views the corporation as a "nexus of contracts" between various corporate stakeholders. Each stakeholder voluntarily associates with the corporation for self-interested reasons, and stakeholders will continue to act selfishly as they try to satisfy their interests to the fullest extent possible during their association with the corporation.

Given that participants are presumed to act selfishly, shareholder primacy proponents argue that agency costs can inhibit efficient wealth-creation. For instance, as directors do not usually receive a proportionate percentage of any wealth increases that they create, they may not always be motivated to create value or improve the efficient allocation of resources in the

39 See e.g. Vanderpol and Waitzer, *supra* note 6 at 656.
40 Stout, *supra* note 8 at 1208.
42 See Lee, *supra* note 18 at 571-72.
As a result, some oversight is necessary. But shareholder primacy proponents argue that non-shareholder stakeholders do not have sufficient incentives to police directors' actions and prevent waste. Most corporate stakeholders are fixed claimants - meaning that their associated returns and risks are fixed by contract. Provided that the company remains solvent, fixed claimants' interests are minimally influenced by the directors' actions. But in modern corporate structures, shareholders are residual claimants. As a result, shareholders bear the risk of any negative performance by the corporation and have the potential for an unlimited upside if the corporation is profitable. Therefore, proponents of the shareholder primacy model argue that shareholders are best placed to police directors' conduct as shareholders have the greatest incentive to encourage innovation, increase efficient allocation of corporate resources, and minimize corporate waste. Proponents argue that in most cases increasing the size of the residual wealth to which shareholders are entitled will also result in corresponding increases in aggregate corporate wealth.

In addition, shareholder primacy proponents favor shareholder action as a way to prevent sub-optimal results and management entrenchment during hostile takeovers. In an efficient market, hostile takeovers are generally successful because the hostile acquirer has found a way to utilize corporate resources more efficiently than the current management. To convince target company shareholders to tender, an acquirer often offers a premium over the target company's current trading price, which represents a percentage of the wealth gains from more efficient allocation of the target corporation's assets. But in such cases, shareholder primacy proponents believe that directors' and shareholders' interests are not aligned. While shareholders desire to increase the price they receive for their shares,

\[ \text{Lee supra note 18 at 537.} \]

\[ \text{MacIntosh, supra note 14 at 74-75.} \]
management often desires to remain in control of the target company, even if it means foregoing a wealth-generating transaction. Therefore, allowing shareholders to tender to the hostile bid will help generate net wealth, even if management would not be in favor of the transaction. Simply put, if the current management does not want - or is not able - to generate value, shareholders will sell to someone who will.

The possibility of shareholders tendering to a hostile bidder can also have a disciplining effect on management. The risk of a hostile takeover can increase directors' incentives to continue to increase firm value and operate the company in an efficient manner. If directors do not, they run the risk of losing control of the corporation. In contrast, directors who do not face the risk of a hostile takeover may be more likely to become complacent.

Lastly, proponents argue that the shareholder primacy model is efficient from a cost-benefit standpoint. According to proponents, the shareholder primacy lays out a clearer mandate than the stakeholder model, and is thus easier for shareholders, courts, and regulators to review and uphold.\textsuperscript{45} In contrast, alternatives that permit consideration of a variety of interests are problematic at they give directors at best uncertain guidance, and at worst an opportunity to make self-interested decisions under the guise of balancing constituents' interests.\textsuperscript{46} In either case, proponents argue that a model that permits consideration of multiple interests is more difficult and expensive to apply.\textsuperscript{47}

2. **Stakeholder Model**

While shareholder primacy remains the favored mechanism for increasing global wealth, several scholars have used the normative framework of the wealth maximization

\textsuperscript{45} See MacIntosh, \textit{supra} note 14 at 75.

\textsuperscript{46} Lupa, \textit{supra} note 35 at 11-12; 17; Millon, \textit{supra} note 2 at 537.

\textsuperscript{47} See MacIntosh, \textit{supra} note 14 at 74.
theory to argue in favor of the stakeholder model. According to the stakeholder model, directors' fiduciary duties extend to groups outside of shareholders, such as employees, creditors, and even the broader community. Proponents of the stakeholder model argue that this comprehensive and flexible approach results in more efficient allocation of resources.

According to one set of arguments advanced by Professor Lynn Stout and Professor Margaret Blair, the stakeholder model is preferable given the realities of corporate associations. Blair and Stout's theory, termed the "team production theory", is premised on the fact that corporate production requires inputs and contributions from a number of non-shareholder groups. According to Blair and Stout, many of these groups rely on implicit commitments in addition to the explicit contractual terms that govern their association with the corporation. While it is often not feasible to incorporate these implicit commitments into a formal contract because of their complexity and uncertainty, Blair and Stout argue that participants still rely on them as part of the basis for their continued association with the corporation.

As a result, Blair and Stout argue that increasing shareholder wealth may not always result in net wealth increases. Instead, wealth may simply be distributed from other corporate constituencies to shareholders. As a result, Blair and Stout argue that the shareholder primacy model could inadvertently create inefficient results through requiring directors to choose the result that is best for shareholders, but not for other corporate participants.

Moreover, Blair and Stout argue that the ex ante effects of the shareholder primacy

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48 Stout, supra note 8 at 1189.
49 Ibid. at 1195-97.
50 Ibid. at 1195-98.
51 Ibid. at 1197.
52 Ibid.
rule can also create inefficient results. In other words, Blair and Stout argue that the shareholder primacy rule creates distrust among other corporate participants and will reduce their motivation to make firm-specific investments or act efficiently. Instead of working to increase the value of the company, other participants will perform at the minimum level required by the contractual terms of their association with the corporation and will likely abandon the corporation when better contractual terms become available elsewhere. In contrast, Blair and Stout argue that treating non-shareholder stakeholders reasonably and honoring implicit commitments can increase overall corporate wealth as such actions will "encourage managers to be loyal, employees to be committed, creditors to be patient, and governments to be supportive."\(^{53}\)

However, the team production theory has been criticized on several fronts. First, some scholars have questioned whether it would actually produce more efficient outcomes than the shareholder primacy model.\(^{54}\) The team production theory requires more than mediation between various stakeholders whose interests may conflict; it also requires directors to coordinate the production of value across corporate participants. As a result, directors are not accountable to any specific constituency. They may therefore lack incentives to maximize value produced through the team efforts, which could lead to sub-optimal results.\(^{55}\) Additionally, while the team production model could in theory result in greater net wealth through improved stakeholder performance, some have questioned it from a cost-benefit standpoint, given that the standard it creates is difficult to oversee, which


\(^{55}\) See Lee, *supra* note 18 at 550.
places considerable trust in directors.\textsuperscript{56}

Moreover, some have questioned the validity of the theory given the seemingly inconsistent assumptions it makes about corporate participants. As Professor Ian Lee has noted, at the root of the stakeholder theory is a fundamental belief in the trustworthiness of directors: directors are given authority to assess and balance competing interests in making a decision that provides the greatest overall benefit for the corporation and its constituents.\textsuperscript{57} In contrast, shareholders and non-shareholder stakeholders are presumed to be rational self-interested actors. If they were not, directors may not need the range of decision-making authority that the team production theory bestows on them. For instance, decisions could be made through stakeholder consensus or through providing shareholders with sufficient information regarding the various interests that would be affected by their decision. Additionally, if non-shareholder stakeholders were not self-interested or rational actors, they may not need additional incentives to perform above the minimum level required by the terms of their contracts. As Professor Lee has noted, the team production theory does not explain why directors would be considered trustworthy when all other corporate participants are mistrustful and selfish.\textsuperscript{58}

While many proponents of the stakeholder theory would likely acknowledge that at some point directors' ability to prevent shareholders from tendering their shares to a bidder should be constrained,\textsuperscript{59} the stakeholder theory generally grants more deference to directors
than the shareholder primacy theory. In addition, some wealth maximization proponents have argued in favor of greater deference to directors for other reasons. Rather than challenging the shareholder primacy model, these proponents argue that directors are at times better able to assess the value of the company and ensure that wealth-generating transactions are completed given the structural realities of the market system. In particular, proponents argue that directors' superior access to information about the company and shareholders' tendency to tender to coercive, sub-optimal acquisitions makes directors the preferred decision-maker during some hostile takeovers. This aspect of director deference is further considered in the next part.

3. **Director Deference During Hostile Takeovers**

Orthodox conceptions of the wealth maximization theory generally regard hostile takeovers favorably as they move corporate assets from less productive uses to more productive uses. Proponents argue that this reallocation of resources will result in net wealth increases. However, this argument assumes that any wealth increases from the transaction will offset the corresponding costs that are incurred as a result. Proponents of hostile takeovers generally take this for granted: a hostile takeover will be unlikely to occur unless the transaction will produce net wealth increases as it would not be in the hostile bidder's interest to incur costs when no additional value could be extracted. However, some scholars

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60 At least to a certain extent, reasons for this deference may be related to disagreements between shareholder primacy theorists and stakeholder theorists regarding calculation of net wealth. According to the team production theory, for instance, the interests of certain stakeholders with voluntary, firm-specific commitments are considered in the determination of net wealth effects of a transaction. See Stout, supra note 8 at 1197.

61 Examples include legal and regulatory compliance costs when completing the takeover or paying a premium for shares over the current trading price.
have challenged this assumption. First, they argue that markets do not accurately value shares at all times, which can allow a bidder to acquire a corporation at a discount rate. Second, they argue that bids can create sub-optimal situations because of coercion. Shareholders will act in an individually rational manner, but will choose a sub-optimal collective result. Each of these arguments is considered in turn.

i. Access to Information

Some scholars have argued for greater director deference based on the inability of capital markets to value a public company, meaning that a hostile bidder could acquire the company for a premium over the trading price of the shares and still pay less than the actual value of the company. In such situations, the bidder could generate a net wealth increase for itself based on the value at which it acquired the company. But this net wealth increase would be primarily generated through the bidder's acquisition of the target company at a discount, rather than through finding more efficient uses for the target company's assets. As a result, the takeover transaction could actually result in an aggregate loss of wealth in systematic terms, given the costs involved in completing a takeover and the fact that relatively little additional value was generated as a result.

However, the validity of this argument depends on the possibility that a company's market value and intrinsic value could at times diverge. This in turn depends on the level of efficiency that capital markets in the jurisdiction display. According to the efficient capital markets hypothesis, market efficiency is measured by the extent to which a market fully and

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62 See e.g. Lipton, supra note 59 at 1042; Dey and Yalden, supra note 1 at 253.
64 See Ron J. Daniels and Jeffrey G. MacIntosh, “Toward a Distinctive Canadian Corporate Law Regime” (1991) 29 Osgoode Hall L.J. 863 at 876-77.
accurately reflects information in setting the price of securities.\textsuperscript{65} In this regard, there are three different forms of market efficiency, each of which are distinguished based on the market's ability to analyze information.\textsuperscript{66} If a market is weak-form efficient, historical price and trading data of a corporation is reflected in the current price of its shares.\textsuperscript{67} If a market is semi-strong-form efficient, in turn, all publically available information is reflected in a company's share price. As a result, an investor cannot earn excess returns through analyzing and trading on publically available information alone.\textsuperscript{68} In a strong-form efficient market, the share price of a company reflects all information, whether publically or privately available.\textsuperscript{69}

Directors often justify putting a poison pill in place by claiming that the offer does not reflect the intrinsic value of the company, even if it represents a substantial premium over the pre-bid market price of the company's shares.\textsuperscript{70} If markets were strong-form efficient, the directors' claims would be difficult to justify. There would be no reason to believe that directors possess superior information than the market as a whole, and claims that shares were undervalued would be difficult to justify given that both public and private information would be reflected in the market price. In a truly efficient market, the market price of a company would reflect the intrinsic value of that company at any given time. As a result, there would be little reason for directors to claim that the offer undervalues the company.

If markets are semi-strong-form efficient, however, directors' claims may be believable in certain circumstances. Directors are likely to have knowledge of both publically

\begin{itemize}
\item[67] \textit{Ibid.}
\item[68] \textit{Ibid.}
\item[69] \textit{Ibid.}
\item[70] Wachter, \textit{supra} note 65 at 787-88.
\end{itemize}
and privately available information. While the market would have factored publically available information into the share price, the private information known to the directors but not to the market could cause a temporary lag between the intrinsic value of the corporation and its market value.\textsuperscript{71} In this case, it would be reasonable to allow directors a limited period of time before a hostile takeover could be completed, during which time they could disclose privately available information and allow the market to absorb it.\textsuperscript{72} However, once the market absorbs the privately held information and returns to perfect efficiency, directors would no longer be able to resist a premium by claiming it undervalued the company. Instead, they would be required to either negotiate with the hostile bidder for a larger share of the gains from the transaction, or seek out alternative transactions.

Lastly, if markets were weak-form efficient, directors may receive more deference over determinations about the price of the corporation. If markets are not able to accurately translate current information about the corporation into an accurate share price, director's claims about 'undervalued' shares may be true. Given directors' position in the company and their access to both public and private information, they may be better placed to determine what the company is actually worth. At a minimum, one would not be able to determine with certainty whether directors' assessment or the market's assessment was more accurate. Moreover, directors would be afforded a certain amount of time to resist a hostile takeover, given the lag between market prices and intrinsic firm value.

Corporate law studies have shown that Canadian markets tend to be semi-strong form efficient, though they do occasionally display inefficiencies that reduce them to being only

\textsuperscript{71} Wachter \textit{supra} note 65 at 790.

\textsuperscript{72} \textit{Ibid.}
weak-form efficient.\footnote{Daniels and MacIntosh, \textit{supra} note 64 at 873.} As a result, there would appear to be some support for creating a regulatory model in which directors are given additional time to resist a hostile takeover. But this model does not necessarily need to permit directors to actively resist an offer, such as through implementation of a poison pill. Instead, the model could require that any hostile bid remain open for a minimum period of time, during which time the bidder could not take up any shares tendered to the bid and markets prices can self-correct as new information about the company is disseminated and analyzed. Ontario, in fact, has created a similar framework through its structural bid provisions, which require a takeover bid to remain open for a minimum period of time, during which a bidder may not take up shares.\footnote{See \textit{Ontario Securities Act}, R.S.O. 1990, c. S.5, s.98 ["OSA"]] (requiring a takeover bid to remain open for at least 35 days).}

ii. \textit{Shareholder Coercion}

Additionally, some director deference proponents argue that tender offers create a classic "prisoner's dilemma", in which all shareholders individually act rationally, but collectively choose a sub-optimal result. In this regard, proponents challenge wealth maximization theorists' traditional understanding of hostile takeovers: that shareholder responses to a takeover are the equivalent to shareholders 'voting with their feet' as to whether the incumbent management or hostile bidder will be more likely to create wealth.\footnote{In other words, if shareholders believed that the present day value of any increase in residual corporate wealth as a result of management's long-term business strategies was higher than the present day value of the tender price offered by the hostile bidder, a majority of shareholders would likely refuse to tender to the bid.} Instead, proponents argue that shareholder tender decisions are functionally different from shareholder voting as they generally have much more direct and significant economic risks and detriments. They thus claim that shareholders are forced into tendering their shares...
because of the possibility that other shareholders will tender their shares, which will result in reduced share liquidity and possibly lower share prices.\textsuperscript{76}

Some scholars have criticized the assumptions underlying these arguments, and Ontario securities law does have in place certain structural protections that prevent coercion by mandating equal consideration for shareholders, requiring a bid to remain open for a minimum period of time, and permitting shareholders to withdraw tendered shares in certain circumstances.\textsuperscript{77} Arguably, these structural mechanisms address most types of shareholder coercion that arise in the context of a hostile takeover. However, the current structural mechanisms may not completely eliminate shareholder coercion that is related to concerns about reduced liquidity of shares. At present, Ontario securities law permits a hostile bidder to make a partial offer for a target company's shares, which allows a bidder to gain control of a company without actually owning one hundred percent of the company's shares.\textsuperscript{78} While acquisitions generally create synergies that the remaining minority shareholders would equally share, there could be situations in which the resulting synergies do not compensate for reductions in the trading price of the shares due to reduced liquidity. In such situations, shareholders may feel pressured to tender their shares to a hostile bidder given the potential that their shares will be worth less if they do not.

B. \textit{Community Actor}

According to the community actor theory, directors are best placed to mediate between different stakeholder's interests and determine how the corporation can best fulfill

\textsuperscript{76} See Lipton, \textit{supra} note 59 at 1042.
\textsuperscript{77} See generally \textit{OSA}, Part XX. See also MacIntosh, \textit{supra} note 1.
\textsuperscript{78} See \textit{OSA}, s.97.2(1).
its duty as a responsible community member. While the approach of the community actor model in many ways resembles that of the stakeholder approach advocated by the team production model, there are several subtle differences. For instance, under the team production model, the world of stakeholders that directors may consider are generally limited to those parties that have made voluntary, irrevocable investments in firm-specific assets. While other parties may be affected by a transaction, they do not have a role in the firm's team production unit and therefore do not have a direct effect on the efficiency of the firm.

Under the more expansive community actor model, such as the version elaborated by the Canadian Supreme Court in *BCE v 1976 Debentureholders*, and *Peoples v Wise*, directors may consider a wider variety of interests, such as the environment and presumably the community in which the corporation is located. These interests would be unlikely to be considered under the team production model.

It is also conceivable that directors' mandates and the oversight to which they are subject under the community actor theory would not measurably change in the face of a hostile takeover. As Professor Edward Iacobucci has noted, the community actor theory does not provide a principled reason for imposing a stakeholder-centric duty on directors in normal circumstances but a shareholder-centric duty during hostile takeovers. If anything, stakeholders' interests during a hostile takeover would be even more pressing. At the root of

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79 See VanDuzer, *supra* note 35 at 206-07.
80 See Lee, *supra* note 59 at 110.
81 2008 SCC 69.
82 2004 SCC 68.
83 See Lee, *supra* note 59 at 110 n.12; VanDuzer, *supra* note 35 at 206-07.
84 See Iacobucci, *supra* note 35 at 248-54 ("It would be difficult to reconcile [the Peoples decision]...with a rule that provides that in takeover settings directors owe fiduciary duties to shareholders not other stakeholders.").
the community actor theory is the belief that contracts and laws alone are not sufficient to protect the rights of corporate stakeholders other than shareholders; instead, stakeholders may also need protection through having their rights represented in internal corporate decisions. During a hostile takeover, non-shareholder stakeholders are even more vulnerable than usual as their fates are generally tied to the company. In contrast, shareholders can exit the corporation fairly easily, provided that a liquid market exits for the company's shares.\footnote{See \textit{Ibid.} at 250.}

While some have argued that the community actor model grants flexibility so that directors can address complex situations that arise, some wealth maximization scholars have challenged the fact that most conceptions of the model do not provide a framework for assigning appropriate weight to each stakeholder interest. This can raise significant problems for oversight of director's decisions, particularly when directors have the potential to be conflicted. In fact, scholars have argued that takeover situations should be treated as conceptually different than normal situations, given the strong potential for conflicts of interest on the part of directors.\footnote{See e.g. \textit{Ibid.}.}

Additionally, if corporate actors are presumed to be self-interested, the community actor model arguably suffers from similar analytical problems as the team production model, in that it does not explain why directors should be trusted with decisions as opposed to shareholders or other stakeholders.\footnote{If directors and shareholders do not act in accordance with their self-interest, the community actor theory could be supported based on the fact that directors may have better access to information than other stakeholders and can therefore better understand the effects of a decision on all corporate participants. However, most corporate law scholarship acknowledges the premise that corporate participants act in a self-interested manner, at least to some extent.} While one could argue that other stakeholders are unlikely to objectively consider the interests of other stakeholders given their own,
potentially divergent interests, the theory does not provide a sufficient answer as to why directors should be expected to function as an "enlightened breed of Philosopher Kings", particularly given that their own interests are often implicated in a decision. 89

C. Role of External Regulators

The wealth maximization model and the community actor model also provide different answers regarding the role of courts and securities commissions in shaping corporate decisions. 90 For instance, proponents of the wealth maximization model generally favor a limited role for regulators and courts as this produces most cost-efficient results. According to proponents, public policy should provide a set of default contractual terms for which participants would likely have bargained if transaction costs did not exist. 91 When markets are functioning correctly, proponents of wealth maximization generally argue that private contracting can create more efficient results than external regulation. As a result, regulators and courts should merely ensure that conditions exist for optimal contractual arrangements and that the contractual terms governing the various participants' associations are respected. 92

89 See MacIntosh, supra note 35 at 256. While some may respond that directors, as opposed to other shareholders, are bound by fiduciary duties that require them to act in the best interests of the corporation, skeptics would argue that fiduciary duties are only as good as their ability to be enforced.

90 According to one commentator, the question of regulatory or judicial interference revolves primarily around the question of whether "there are public interests or public goods which the company ought to serve, or whether the company is best treated as a private association with as little regulation as possible, or even no regulation at all." John Parkinson, Andrew Gamble, and Gavin Kelly, "Introduction: The Political Economy of the Company" in John Parkinson, Andrew Gamble, and Gavin Kelly, eds., Political Economy of the Company (Portland: Hart Publishing, 2002) 1 at 5. According to Parkinson, Gamble, and Kelly, a comparative analysis of jurisdictions demonstrates that corporations can be private associations, public bodies, or a combination of the two. Ibid. at 5-6.

91 Easterbrook and Fischel, supra note 41 at 1418, 1428.

92 See Easterbrook and Fischel, supra note 41 at 1446.
While wealth maximization theorists generally prefer private contracting over external regulation, there are some situations in which external influence is necessary as market forces can produce sub-optimal results. In such cases, proponents argue that regulators should endeavor to make markets competitive and remove obstacles to enterprise, so that wealth-increasing transactions can occur.\(^93\) For instance, when participants' actions create negative externalities for non-contracting third parties or optimal contractual terms would be foreclosed because of market competition issues, regulators should modify the default contractual terms to restore efficiency to the market.\(^94\) Additionally, proponents emphasize the importance of ensuring that private corporate negotiations comply with generally applicable contractual principles, such as voluntary choice, competence, and lack of fraud.\(^95\) Provided it is cost-efficient, proponents also generally favor regulation that increases the information disseminated to markets, which can result greater efficiency and a more accurate valuation of firm assets.

In contrast, proponents of the community actor theory favor a greater role for regulators.\(^96\) While proponents of the wealth maximization theory generally advocate for a \textit{laissez-faire} regulatory approach, premised on the assumption that a corporation is formed as a result of private negotiations between participants, community actor theorists argue that the corporation's public nature justifies greater involvement of the community and the political process.\(^97\) Moreover, given the corporation's extensive social involvement, regulatory

\(^{93}\) Parkinson, Gamble, and Kelly, \textit{supra} note 90 at 5.
\(^{94}\) See Easterbrook and Fischel, \textit{supra} note 41 at 1434, 1436-37.
\(^{95}\) See Easterbrook and Fischel, \textit{supra} note 41 at 1434.
\(^{96}\) Parkinson, Gamble, and Kelly, \textit{supra} note 90 at 5.
mandates may focus not just on promoting market efficiency, but "proactively advancing social goals." But while proponents recognize the importance of the external process in shaping the corporation's activities, most recognize that this should not replace self-regulation through deliberative internal governance. Instead, corporate decisions regarding the role of the corporation and the ethical ramifications of its activities should be guided by deliberations within the corporate governance mechanism.

IV. **Theory and Action: The Ontario Securities Commission's Stance**

A. **Underlying Framework of Securities Law**

In determining the answers to the two fundamental questions mentioned above, securities regulators do not begin with a blank slate. Instead, they are guided by the legislation under which they operate. In Ontario, the Ontario Securities Commission is required to regulate consistent with the goals of the *Ontario Securities Act* ("OSA"). In section 1.1, the OSA's goals are outlined as follows:

(a) to provide protection to investors from unfair, improper or fraudulent practices; and
(b) to foster fair and efficient capital markets and confidence in capital markets.

As made clear by section 1.1, the OSA is predominantly shareholder-centric in focus, though the efficiency framework it proposes could in theory provide some space for efficiency-based models like the "team production theory". But it would appear that theories like the community actor model would be difficult for securities regulators to incorporate, at least under the current framework of the OSA. Moreover, underlying in the purposes of the

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98 See Waitzer and Jaswal, supra note 23 at 488-89.
99 See Lee, supra note 18 at 584.
100 *OSA*, s.1.1.
OSA is a strong element of investor protection. While investor protection could be interpreted as instrumental to instilling confidence in capital markets and promoting efficiency, it has taken on a principled meaning of its own. In other words, welfare maximization theorists may argue that investor protection is necessary to the extent that it reduces information asymmetries or distrust that can hinder the consummation of wealth-generating transactions. However, courts and securities commissions have generally interpreted investor protection as a goal in itself, rather than a mechanism for facilitating more efficient markets.\(^{101}\) Given this context, investor protection and efficiency can sometimes be at odds; in fact, the OSA recognizes this conflict and instructs securities regulators to balance between these competing regulatory goals.\(^{102}\) But despite this potential conflict, regulators should endeavor to adopt policies and regulations that are consistent with both goals, to the extent that this is possible.

The OSA also instructs securities regulators to foster efficient markets. While the OSA does not define the term efficiency, it does provide some indications of what the concept entails. At least one conception of efficiency represented by the OSA is cost-benefit analysis. Section 2.1(6) of the OSA instructs the Commission to consider whether the constraints and

\(^{101}\) Early U.S. cases - SEC v. Howey Co., 328 U.S. 293 (1946) and Hawaii v. Hawaii Market Center, 485 P.2d 105 (1971) - adopted a strong, almost paternalistic view of investor protection. The Canadian case Pacific Coast Coin Exchange v. Ontario Securities Commission, [1978] 2 S.C.R. 112 relied on these U.S. cases to adopt a similar stance and reject a weaker caveat emptor investor protection model offered by the dissent that would arguably have allowed freer movement of capital and would therefore have been more in line with facilitating efficient markets. See also Jeffrey G. MacIntosh, "Securities Regulation and the Public Interest: Of Politics, Procedures, and Policy Statements - Part I" (1994) 24 Can. Buss. L. J. 77 at 116 (mentioning that investor protection was the original focus of securities regulators in Ontario); Christopher Armstrong, Moose Pastures and Mergers: The Ontario Securities Commission and the Regulation of Share Markets in Canada, 1940-1980 (Toronto: University of Toronto Press, 2001) at 17 (mentioning that the primary argument for extensive disclosure in Ontario securities laws was based on investor protection rationales).

\(^{102}\) See OSA, s.2.1(1).
costs placed on market participants are proportionate to the significance of the regulatory objectives. Another aspect of efficiency is represented in the arguments of wealth maximization theorists: securities regulators should support the free movement of capital and unrestricted transfer of assets from less efficient to more efficient uses. Although not explicitly endorsed by the OSA, securities regulators appear to have incorporated this aspect of efficiency, at least in the takeover bid context.

The OSA also emphasizes the importance of fostering fair capital markets. Interestingly, the OSA does not provide a concrete definition of what fairness entails, though provisions of the OSA indicate that fairness does involve procedural components. Additionally, while not directly reflected in the OSA, securities regulators' interpretations of the OSA and corporate scholarship have indicated that fairness may also involve substantive concerns. Given that the term "fairness" is subject to different meanings, particularly when questions of substantive fairness arise, it is possible to arrive at different conclusions regarding what constitutes a "fair market" depending on whether one emphasizes the corresponding goal of market efficiency or investor protection.

Procedural fairness can also be subject to different meanings, though investor protection and efficiency are often aligned in the requirements that should be in place. Consider, for instance, procedural fairness rules in the OSA that require a hostile bidder disclose information so that shareholders can make an informed choice whether or not to tender to the offer. In such cases, the rule is consistent with the efficiency goal as it reduces transactional costs from information asymmetries. The rule also satisfies the investor...
protection goal as it prevents a bidder from taking advantage of shareholders based on non-public information.

However, in some situations, efficiency and investor protection diverge. For instance, procedural rules that require equal treatment of shareholders would tend to be disfavored from the standpoint of efficiency as can make transactions more expensive to complete and inhibit the transfer of resources from less efficient to more efficient uses. But securities law has generally sided with investor protection on these issues. Procedural fairness also regulates the mechanism by which the target company obtains a final price for the company assets, though views as to the appropriate mechanism can differ. In each case, however, one important point should be noted: procedural fairness is ambivalent to the fairness of the actual price offered to shareholders, provided that the prescribed structural protections are in place.

Substantive fairness, on the other hand, is concerned with the price at which a bidder buys the target company's shares. According to Professor Jeffrey MacIntosh, determinations as to the fairness of the price offered to target shareholders raise distributive and efficiency considerations. In an efficient market, bid premiums over the pre-market share price of a target company reflect that fact that the transaction will generate increased value through more efficient management or realization of synergies between the target and

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104 See OSA, s. 94, s.97 (requiring equal treatment of and identical consideration for all shareholders).
105 On one hand, Canadian securities law has shown a preference for using market mechanisms, particularly unrestricted auctions, once a hostile bid is launched. See National Policy 62-202, Take-Over Bids – Defensive Tactics (1997), 20 O.S.C.B. 3525, s.1.1(5) ["National Policy 62-202"]. On the other hand, other jurisdictions like the Delaware have remained open to the possibility that long-term value for shareholders may also be achieved through an independent corporate strategy that does not involve sale of the company.
106 See Dey and Yalden, supra note 1 at 258.
107 MacIntosh, supra note 1 at 330.
bider company. According to the distributive aspect, fairness requires determining what percentage of this increased value should be allocated to target shareholders through an increased bid premium, and what percentage the hostile bidder should retain.\textsuperscript{108} In most cases, opinions regarding whether a price is "fair" involve normative underpinnings regarding how wealth gains from the transaction should be allocated. When considered from the perspective of efficiency, a fair price can be determined solely through market price, since the company's value is reflected in it.\textsuperscript{109} According to the efficiency framework, it is difficult to conceive why shareholders deserve to receive a premium over the market price of shares.\textsuperscript{110} Additionally, efficiency indicates that fairness of price should be determined with regard to the market as a whole.\textsuperscript{111} As target shareholders extract more value from a bidder, the bidder's returns from the transaction will decrease.\textsuperscript{112} Lower systematic returns for bidders will likely result in fewer takeovers, which would mean that less value would be realized by the market as a whole.\textsuperscript{113} To the extent that the threat of a hostile takeover is decreased, management may also be less motivated to maximize value, which could result in inefficient management. This in turn would create less valuable companies, and thus lower share prices.

\textsuperscript{108} Ibid.
\textsuperscript{109} Anand, supra note 66 at 120.
\textsuperscript{110} See MacIntosh, supra note 1 at 330 (questioning whether target shareholders deserve to share in any gains). See also Anand, supra note 66 at 122 (mentioning arguments against premiums based on the fact that the price at which shareholders initially purchased shares was discounted to reflect the absence of a control premium and the possibility of a buy out).
\textsuperscript{111} See MacIntosh, supra note 1 at 330.
\textsuperscript{112} See Ibid.
\textsuperscript{113} See Ibid.
In contrast, the investor protection framework would indicate that the market price of a company's shares might not always determine the fairness of an offer.\textsuperscript{114} In particularly, when markets are not perfectly efficient, the share price of a company may sometimes diverge from the intrinsic value of the company's shares. Thus, market price alone may not set a "fair" price as it may not always reflect the actual value of the company.

In addition, several elaborations of the investor protection framework posit that a "fair" price for shareholders should include a percentage of the wealth gains from the transaction.\textsuperscript{115} These arguments are controversial, and arguably questionable, given that the incorporate the normative framework of the aggregate private property model. According to proponents, tender offers often allow bidders to take advantage of widely dispersed and poorly organized shareholders by offering a relatively small percentage of the wealth gains from the transaction.\textsuperscript{116} Provided directors are not conflicted, investor protection would permit defensive tactics as they allow management of the target company to function as a collective bargaining unit to obtain a fair price for shareholders.\textsuperscript{117}

B. Manifestation in Securities Regulation

Although the OSA provides a framework that the Commission must follow, the goals of the OSA are sufficiently ambiguous to provide the Commission with significant space in which to regulate. The Commission's chosen mode of operation is primarily reflected in National Policy 62-202, which provides non-binding guidelines regarding the Commission's anticipated response to defense tactics during takeovers. Defense tactics can also be challenged before a panel hearing, and the Commission has also developed its own

\textsuperscript{114} See e.g. Dey and Yalden, supra note 1 at 276; Anand, supra note 66 at 120.
\textsuperscript{115} See Dey and Yalden, supra note 1 at 271; Anand, supra note 66 at 122.
\textsuperscript{116} Dey and Yalden, supra note 1 at 271.
\textsuperscript{117} See Dey and Yalden, supra note 1 at 277; Waitzer and Vanderpol, supra note 6.
jurisprudence on poison pills. As National Policy 62-202 was adopted in 1986, before the wave of hostile takeovers reached full force and before poison pills were created in response,118 these panel decisions supplement National Policy 62-202 and provide a more complete picture of the Commission's current regulatory stance.

1. National Policy 62-202

Not surprisingly, National Policy 62-202 is primarily concerned with investor protection. Section 1.1(2) of the Policy, for example, states that the primary objective of takeover bid law is the "protection of the bona fide interests of the shareholders of the target company." The Policy goes on to indicate the substance of this protection in the context of takeover bids: shareholders of the target company should be free to make a fully informed decision to accept or reject a tender offer.119 According to the Policy, regulatory intervention is required as directors' interests may be different than shareholders' interests during a hostile takeover, and management may thus use their position of power to implement defensive tactics that thwart shareholder action.120

But National Policy 62-202 also contains strong statements in support of efficiency and wealth maximization. In particular, the Policy endorses arguments generally offered in support of wealth maximization: takeovers play a role in disciplining management, and takeovers reallocate economic resources to their best uses.121 While the former statement could fit within the investor protection paradigm - as better-disciplined managers will

119 National Policy 62-202, s.1.1(2).
120 National Policy 62-202, 1.1(1).
121 While National Policy 62-202 does not specifically equate "best" with "most efficient", its recognition of unrestricted auctions as the preferred mechanism indicates that this is so. See National Policy 62-202, 1.1(5).
generate more wealth for investors and will be less likely to misuse corporate assets - the latter arguably has little relation to investor protection. Other aspects of the Policy also indicate a bias towards the wealth maximization theory. For instance, the Policy incorporates market mechanisms - unrestricted auctions - as the preferred process for responding to a takeover bid and increasing shareholder returns. Implicit in this preference is the assumption that markets are sufficiently efficient to reflect the intrinsic value of the corporation and generate a satisfactory price. Additionally, while the Policy recognizes that defensive tactics may be used to the advantage of shareholders, its acquiescence appears somewhat reluctant.

But the Policy does contain a notable endorsement of investor protection, particularly investor property rights. While the Policy cautions that securities regulators will examine tactics that are deemed to be abusive to shareholder rights, it also recognizes that prior shareholder approval could allay regulators' concerns. Thus, much to the consternation of wealth maximization theorists, the Policy in theory places shareholder choice over efficiency concerns. In other words, the Policy leaves open the possibility that shareholders could collectively act through management in order to hold out against a takeover or extract a larger premium from potential bidder, even if the resulting actions inhibit a wealth-generating transaction from occurring.

2. **Poison Pill Decisions**

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122 National Policy 62-202, 1.1(5).
123 Admittedly, regulators' reluctance could be in part because of suspicions that management would try to protect their own interests under the guise of protecting shareholder interests. See National Policy 62-202, 1.1(5).
124 National Policy 62-202, 1.1(3).
The foundational principles underlying National Policy 62-202 - economic efficiency and investor protection - are also reflected in the Commission's poison pill jurisprudence.\textsuperscript{125} The foundation of Canadian poison pill jurisprudence was set by the Commission's decision in \textit{Re Canadian Jorex Limited} in 1992.\textsuperscript{126} In this case, the Commission adopted the stance that poison pills, while an authorized use of corporate power, were only legitimate to the extent that they were used to buy time to solicit other offers or encourage an auction process. But the time afforded to directors to solicit other offers was not unlimited. The \textit{Re Jorex} decision adopted the stance that "there comes a time when the pill must go", meaning that it could not be used as a mechanism to proceed with an independent business strategy.\textsuperscript{127} In later cases, the Commission refined and clarified the underlying wealth-maximization considerations that influenced its decision to cease trade poison pills. For instance, in \textit{In the Matter of MDC Corporation and Regal Greetings and Gifts Inc.}, the Commission clarified that a poison pill may be allowed to stay in place for an extended period of time provided that the directors have a real possibility of maximizing shareholder value.\textsuperscript{128} But in its subsequent decision in \textit{Re Cara}, the Commission clarified that the longer a pill stays in force, the more difficult it will be for the target directors to justify the pill's continued operation as a wealth-

\begin{footnotesize}
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\item \textsuperscript{125} See Ronald Podolny, "Fixing What Ain't Broke: In Defence of Canadian Poison Pill Regulation" (2009) 67 U. Toronto Fac. L. Rev. 47 at 87.
\item \textsuperscript{126} \textit{Re Canadian Jorex Limited and Mannville Oil & Gas Ltd.} (1992), 4 B.L.R. (2d) 1 (O.S.C.).
\item \textsuperscript{127} See \textit{CSA Proposed Rule} at 2648.
\item \textsuperscript{128} \textit{In the Matter of MDC Corporation and Regal Greetings and Gifts Inc.} (1994), 17 O.S.C.B. 4971, 5 C.C.L.S. 1118. These considerations were eventually incorporated into a series of factors that the Commission uses to determine whether a poison pill should be removed. They are as follows: whether shareholder approval for the poison pill was obtained; when the poison pill was adopted; whether there was broad shareholder support for the pill's continued operation; the number of potential viable alternatives; the nature of the hostile bid, including whether it is coercive or unfair; and the likelihood that the bid will not be extended. See \textit{In the Matter of Royal Host Real Estate Investment Trust and Canadian Income Properties Real Estate Investment Trust} (1999), 22 O.S.C.B. 7819.
\end{itemize}
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maximization device. In most cases, the Commission has followed the "pill must go" model adopted in Re Jorex: the Commission generally overrides directors' decision to implement a poison pill within a relatively short period of time, usually in 45 to 60 days, and in most cases no more than 70 to 90 days.

Given the OSA's goal of investor protection, shareholder choice has also featured prominently in the Commission's decisions. In Re Cara, for instance, the Commission clarified that while directors can assist shareholders in making a decision, the final decision should rest with the shareholders. In Re Neo Material Technologies, the Commission's decision on a poison pill was heavily influenced by prior shareholder approval. In its subsequent decision in Re Baffinland Iron Mines Corp., the Commission indicated that its decision in Re Neo Material Technologies was not an example of deference to the target

130 See Sean Vanderpol and Edward J. Waitzer, "Addressing the Tension between Directors’ Duties and Shareholder Rights—A Tale of Two Regimes" (2012) 50 Osgoode Hall L.J. 177 at 189. In some cases, the Commission has allowed a pill to stay in place for a significantly longer period of time. But these cases generally represent extraordinary circumstances in which existing market conditions would produce sub-optimal results. In Re Falconbridge, for example, the Ontario Securities Commission allowed a poison pill to remain in place for an additional 30 days, despite the fact that it had already been in place for over nine months. See Re Falconbridge Ltd. (2006), 29 O.S.C.B. 6783, 21 B.L.R. (4th) 321 (O.S.C.). However, the context of the Re Falconbridge takeover may have influenced the Commission's decision. Specifically, the hostile bid was only launched after a friendly takeover bid by Inco. Moreover, the hostile bidder - Xstrata - was already a significant shareholder of Falconbridge and chose to launch a partial bid for a percentage of Falconbridge's shares, rather than a full bid for all outstanding shares it did not own. As a result, the hostile bid could easily have been construed by regulators as a strategy by Xstrata to frustrate a legitimate takeover by Inco and retain control of Falconbridge. Moreover, although shareholders had not approved the extension of the pill, which could raise suspicions of management entrenchment, this would have been difficult as Xstrata held a significant position in the company and could therefore control the vote.

131 See Re Neo Material Technologies, [2009] 32 O.S.C. Bull. 6941. Interestingly, the Commission also referred to and appeared to acknowledge the importance of directors' BCE duties. However, securities regulators later clarified that this was not to be construed as deference to a stakeholder model of corporate governance. See Re Baffinland Iron Mines Corp. (2010), 33 O.S.C.B. 11385, 77 B.L.R. (4th) 143.
company's directors or an invitation for a target company board to "just say no" to a hostile takeover, but an acknowledgement that shareholders felt that the deal offered by the hostile bidder was not their best option.\textsuperscript{132}

3. \textbf{Criticisms of the Current Regime}

The current regime has been criticized on several fronts. First, some critics argue that National Policy 62-202 has in practice favored bidders over target company management, as it creates a regime in which a bidder can push a company into an auction by launching a hostile bid. Moreover, critics of the current regime argue that the current regime's approach to cease trading poison pills can prevent a company from maximizing shareholder value.\textsuperscript{133} Pills are generally cease traded within a relatively short time period, and critics argue that directors do not have sufficient time to seek alternative transactions.\textsuperscript{134} Additionally, the regularity with which poison pills are cease traded means that the board of a target company has limited leverage to force a hostile bidder to negotiate for a higher price; instead, a hostile bidder can simply keep a tender offer open until the poison pill is removed. Some commentators have also argued that securities regulators are overly concerned with short-term wealth creation through encouraging an auction process, as opposed to longer-term wealth creation through independent business strategies.\textsuperscript{135}

\textsuperscript{132} See \textit{Re Baffinland Iron Mines Corp.}, supra note 131.

\textsuperscript{133} See e.g. Ian C. Wildgoose Brown, "Hard to Swallow: The Canadian Poison Pill from an American Perspective" (2012) 36 Seton Hall Legis. J. 297; Podolny, \textit{supra} note 125; CSA \textit{Proposed Rule} at 2647; Vanderpol and Waitzer, \textit{supra} note 130 at 189.

\textsuperscript{134} CSA \textit{Proposed Rule} at 2647.

\textsuperscript{135} See Brown, \textit{supra} note 133 at 322. But it should be noted that this criticism assumes that markets are relatively inefficient. If markets can accurately determine the intrinsic value of the corporation and reflect any information disseminated by management in response to a hostile bid, they could analyze and price the worth of the independent business strategy as opposed to the takeover bid.
Some commentators have also criticized the regime as exacerbating collective action problems for shareholders. Shareholder can be pressured into tendering their shares in order to receive timely payment or avoid reductions in share price as shares become less liquid.\textsuperscript{136} Some have also criticized securities regulators' stance as it creates a more favorable takeover regime than other jurisdictions, which can contribute to the "hollowing out" of the Canadian corporate market, particularly from cross-border acquisitions by U.S. companies.\textsuperscript{137} However, as such criticisms are generally focused on hostile acquisitions as opposed to friendly acquisitions that could have the same effect, some scholars have questioned whether the motives underlying these claims are based on principle or politics.\textsuperscript{138}

Some commentators have also criticized the fact that current securities regulatory paradigms do not reflect market and governance developments. Since the adoption of National Policy 62-202 and the Commission's decision in\textit{ Canadian Jorex}, which set framework for the modern securities regulatory approach, certain developments have arguably changed the assumptions on which the initial securities regulatory policy was based.\textsuperscript{139} Additionally, since the adoption of the current framework, the Canadian Supreme Court has taken a stakeholder-centric approach, most notably through its decisions in\textit{ BCE} and\textit{ Peoples}. While National Policy 62-202 specifically rejects a code of conduct by which directors must abide, some have argued that it effectively forces directors into a shareholder primacy model that can conflict with the more expansive conception of fiduciary duties.

\textsuperscript{136} CSA Proposed Rule at 2647.  
\textsuperscript{137} CSA Proposed Rule at 2647; Nicholls,\textit{ supra} note 3 at 205, n.35.  
\textsuperscript{138} See Nicholls,\textit{ supra} note 3 at 203.  
\textsuperscript{139} See CSA Proposed Rule at 2648 ("These developments include the adoption of relatively standard form 'permitted bid' Rights Plans, more cross-border bids that require increased time for the board to respond, changes in board governance practices and greater shareholder activism.").
under corporate law.\textsuperscript{140}

In addition, some have criticized the indeterminacy that the current regime can create. While decisions by securities regulators have been fairly consistent,\textsuperscript{141} some argue that inconsistency can arise at the edges of securities regulatory decisions.\textsuperscript{142} In particular, different jurisdictions or panels may not always come to the same decision. According to a recent proposed reform by the Canadian Securities Administration:

These varying determinations can occur as a result of different perspectives on underlying principles, such as the relevance of shareholder approval to the particular circumstances, the relevance of the board’s fiduciary duty obligations when responding to hostile take-over bids, and the significance of the risk of structural coercion of target company shareholders by the bidder in particular circumstances, as they are applied to the facts of a particular case.\textsuperscript{143}

As a result, market participants may not be able to accurately predict the outcome of the panel hearing in every case. This can result in increased uncertainty and thus less efficient outcomes than if participants could predict securities regulators' responses in advance and factor this into their respective takeover strategies.\textsuperscript{144} Additionally, from a cost-benefit standpoint, some commentators have also noted with disapproval the interventionist approach that securities regulators have adopted.\textsuperscript{145} In particular, the current securities regime relies on panel hearings and cease trade orders to generate optimal market outcomes. This can create administrative costs and impose costs on target companies as a result of participation in hearings.

\textsuperscript{140}See e.g. Vanderpol and Waitzer, \textit{supra} note 130; Brown, \textit{supra} note 133 at 305.
\textsuperscript{141}See Waitzer and Vanderpol, \textit{supra} note 130 at 189.
\textsuperscript{142}See Brown, \textit{supra} note 133 at 305, 308, 310.
\textsuperscript{143}\textit{CSA Proposed Rule} at 2648.
\textsuperscript{144}See Brown, \textit{supra} note 133 at 305.
\textsuperscript{145}See Brown, \textit{supra} note 133; Vanderpol and Waitzer, \textit{supra} note 130.
V. **Designing a Better Regulatory Model**

Having outlined the problems with the current regime, this section discusses possible reforms. Part A of the section considers various recommendations that have been suggested, such as reliance on market mechanisms, independent director approval of poison pills, and shareholder approval requirements. Part A also discusses the problems with each of these potential reforms, particularly from the perspective of the investor protection and efficiency framework adopted by the *OSA*. Additionally, Part A highlights ideological inconsistencies and practical difficulties in implementation that decrease the attractiveness of some reforms.

Given the constraints that the *OSA* imposes on the Commission, part B of section considers the possibility of adopting an alternative model of regulation governed by the stakeholder model adopted in *BCE*. In this regard, Part B argues that while such a model may be marginally better at protecting the interests of stakeholders in some cases, it must be weighed against the real possibility that the ambiguity of the stakeholder model could lead to director entrenchment. In contrast, a shareholder primacy model that was supplemented with external regulation would sufficiently protect stakeholders during hostile takeovers without raising the same concerns regarding management entrenchment.

Lastly, Part C proposes the preferred proposal: a structural reform that that incorporates "permitted bid" provisions. After explaining the reform, the Part then explains why it would avoid problems that other reforms face. Part C also discusses the reform's

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146 Note that this section is limited to discussing factors that affect the relative benefits and detriments of poison pill reforms. Other factors, such as ensuring full disclosure of material information, may be relevant in the context of takeover bids in general but are not directly discussed here.
congruence with the goals of the OSA and its ability to be adopted and implemented by the Commission.

A. Potential Reforms

1. Reliance on Market Mechanisms

In contrast to the current interventionist model, some commentators have argued in favor of a laissez-faire approach. Instead of regulating poison pills, the Commission should permit shareholders and management to negotiate an acceptable arrangement on their own terms. The reasons for this reform are several. First, while wealth maximization theorists raise concerns about management entrenchment, several scholars have argued that informal market mechanisms have helped re-align the incentives of management and shareholders during hostile takeover situations.147 For instance, director stock options give directors a powerful incentive to seek the highest price that can be attained during a takeover situation. Additionally, under Canadian corporate law it is relatively easy for shareholders to schedule a shareholder meeting and vote out directors. Unlike in the U.S., where staggered boards make it impossible to vote out a majority of directors within a reasonable time, Canadian shareholders can vote out the entire board in one meeting. Thus, proponents argue that shareholders can initiate proxy battles to remove directors if they do not like directors' use of defensive tactics.

However, certain realities make the laissez-faire model unadvisable. First, from the perspective of investor protection, the laissez-faire model ignores power imbalances in the corporate governance framework that may make it difficult for shareholders to effect change. In particular, retail shareholders are often widely dispersed, which can create collective

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action problems. Similarly, although institutional shareholders like financial institutions and trust companies often own a significant percentage of shares in Canadian companies, their effect on the voting process is arguably compromised due to institutional co-option. Even if institutional shareholders do not agree with the course that management has taken, they may be afraid to vote against management:

Many, or perhaps even most, institutional shareholders may fear reprisals from voting against management. Banks may fear loss of deposit or lending business. Trust companies may fear loss of pension or fund management fees, or the withdrawal of the personal trust plans of senior management. Insurance companies may fear the cancellation of lucrative insurance coverage, whether it be corporate asset or liability coverage, D & O insurance, or other forms of insurance underwriting.  

The laissez-faire model is also problematic when management holds a sizable voting block of shares. In such cases, it may be difficult to dissenting shareholders to overcome management's voting power.

From the efficiency perspective, the laissez-faire model is also problematic. Although it avoids the efficiency problems that are created through the current regulatory model, it raises efficiency concerns of its own. Even if dissenting shareholders have sufficient voting power, they must go through a circuitous process to remove defense tactics. It would be better to give shareholders the ability to act directly, rather than requiring them to act indirectly on the removal of a poison pill through voting to remove directors during a proxy

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contest. Moreover, requiring shareholders to first go through proxy contests to remove impediments to tender to a bid may discourage at least some wealth-generating transactions. While some bidders may be willing to invest the time and resources necessary to keep a takeover bid open while a lengthy proxy contest is being waged, others may not.

Lastly, the laissez-faire model is not optimal from the perspective of cost-efficiency. The laissez-faire model would create significant costs that would be unlikely to produce any benefits over alternative proposals. For instance, it would require dissenting shareholders and management to devote significant time and resources to preparing circulars, issuing press releases, and gathering votes. In addition, the meeting itself would create costs for the corporation: proxy materials would need to be prepared and sent to shareholders, and management would need to schedule and hold a meeting.

2. **Independent Director Approval**

Another reform proposal would allow a poison pill to remain in place provided a special committee comprised of independent directors approves it.\(^{149}\) This reform would have several advantages of the market mechanisms model discussed above. First, from the efficiency perspective, it would be more cost-efficient. Rather than requiring shareholders to vote indirectly to remove a pill, decisions could be made by the independent committee in a much more cheaply and with less disruption. Additionally, an independent director approval requirement would allow the corporation to adapt quickly to changing circumstances or bid prices. In contrast, the market mechanisms proposal would be relatively less flexible and

would likely result in extended proxy battles, which could derail wealth-generating transactions. To the extent that market inefficiencies caused disparities between intrinsic value and market value, the independent director model would also help prevent transactions that benefit an acquirer, but result in an overall loss of wealth.

From the perspective of investor protection, the independent director proposal may face practical constraints as securities regulators may be reluctant to adopt a reform that did not put the choice to tender directly in the hands of shareholders. But assuming securities regulators did not raise issue, the independent director model could have certain advantages over other proposals if adopted. First, it would address concerns that shareholder coercion may affect shareholders' propensity to tender to an inferior offer, which results in procedural unfairness. The independent director model would allow independent directors to implement and retain defensive measures until coercive bid conditions were revised. More controversially, the independent director model would permit independent directors to serve as a collective bargaining unit for shareholders, thus increasing the premiums that shareholders could extract from the acquirer. While the underlying rationale for such actions is questionable, the proposal would nonetheless appeal to those scholars and securities regulators who have subsumed elements of the aggregate private property model into their theoretical frameworks.

On a different note, the independent director proposal would in some ways reconcile the respective positions of stakeholder theorists and shareholder primacy theorists. On one hand, the independent director model would use the corporation's internal governance model to make decisions. Provided that securities regulators deferred to the independent committee's decision, the proposal would allow independent directors to consider the
interests of stakeholders other than shareholders under their fiduciary duties framework elaborated by the Canadian Supreme Court. Additionally, the internal governance framework would address the concerns of scholars like Professor Lee, who argue that external regulation does not fully internalize third-party rights. On the other hand, the independent director model could in theory address the concerns of shareholder primacy theorists. At the root of the shareholder primacy model is a distrust of management. This distrust is particularly acute during hostile takeovers, given that management entrenchment and self-interest can inhibit wealth-maximizing transactions. But if the special committee was truly independent, it could conceivably avoid such personal conflicts and objectively analyze the situation to come to the most efficient result.

But herein lies the independent director model's fatal flaw. While it could in theory provide a superior mechanism for maximizing corporate wealth, it is questionable whether directors could ever maintain the level of independence and objectivity that the proposal requires. First, the model relies on directors (albeit independent directors) to determine why their company is undervalued. Second, the model requires directors to maintain a certain level of disinterest in the transaction. In the context of a hostile takeover, both of these pre-requisites would be difficult to attain.\(^\text{150}\)

As to the first point, the special committee could approve implementation of a poison pill if it believed in good faith that a hostile bid took advantage of market inefficiencies or coerced shareholders to tender. However, while this may well be a concern, there could be other reasons for the timing of the bid. The bid may in fact demonstrate that the company is not being operated as efficiently as it could be. Thus, the hostile bidder, rather than being a

\(^{150}\) But see Gordon, supra note 63 at 1563 (arguing that independent directors may be able to objectively analyze the value of the firm in change of control situations).
corporate raider, may be seizing an opportunity to gain control of the company and operate it more efficiently. But given the independent directors' position in the company, they could have trouble determining which of these factors was the cause. Moreover, they would arguably choose the former reason with much greater frequency than it actually occurred. The potential for such results could significantly undermine the disciplining effect of hostile takeovers.

One presumes that the independent directors are making the choices that they believe to be in the best interests of the corporation. If they did not, they would not be sufficiently trustworthy to determine the course of the company during a critical corporate event like a hostile takeover. Assuming that directors were using their best efforts, if they were aware of any business strategy that would increase the value of the corporation, they would conceivably implement it. Thus, there could be situations in which the bid reflects the fact that the hostile bidder knows how to run the company more efficiently, a fact of which independent directors are unaware.\(^{151}\) But the independent directors could still decide, in good faith but incorrectly, that the hostile bid undervalued the corporation when it fact it simply offered a more efficient way to use the corporation's assets.

As to the second point, several scholars have questioned whether independent directors can ever be truly independent during a hostile takeover.\(^{152}\) Securities law has successful adopted independent director approval mechanisms in other areas, such as squeeze outs and going private transactions. But hostile takeovers are conceptually different in that all

\(^{151}\) This of course assumes that the bid is a result of current management's indiscipline rather than other factors (i.e., that any gains from the acquisition would result from more efficient management of the company, as opposed to synergies or cost savings).

\(^{152}\) See e.g. Bryan Ford, "In Whose Interest: An Examination of the Duties of Directors and Officers in Control Contests" (1994) 26 Ariz. St. L.J. 91.
directors, including independent directors, risk losing their jobs if the hostile takeover succeeds.

3. **Shareholder Approval**

Under another reform proposal, a target company would be allowed to keep a poison pill in place indefinitely provided that a majority of shares have approved its implementation either before a hostile takeover bid or, if the pill is put in place in response to a bid, within a reasonable time after the pill is implemented.\(^{153}\) Additionally, the proposal would permit shareholders to remove a poison pill upon a majority vote of shares, other than those owned by a hostile bidder or its joint actors. In theory, this would put the decision as to whether to keep or remove a poison pill squarely in the hands of shareholders. It would also address shareholder collective action problems and help prevent shareholders from being coerced to tender to a sub-optimal bid.

On its face the proposal is advantageous primarily from the perspective of investor protection, and may therefore seem like the preferred reform for the Commission given its emphasis on this goal. But the proposal also has features that are attractive from the standpoint of efficiency. For instance, the shareholder approval model, while less cost-efficient than the independent director reform, would create less costs than a protracted proxy contest. In addition, the shareholder approval requirement could help create a process that would 'streamline' poison pills. Under the market mechanism reform, for instance, shareholders bear the burden of inertia to remove a pill. Unless they can assemble a sufficient number of votes, the pill will remain in place. In contrast, under the shareholder vote provision the burden of inertia would shift from shareholders to directors. In order to have

\(^{153}\) See *CSA Proposed Rule.*
put a poison pill in place, directors would need to secure a majority of shareholder votes. While some of these votes may come from insiders of management-friendly shareholders, at least some votes would likely need to come from non-affiliated shareholders. In order to attract these votes, management would need to convince shareholders why a poison pill was necessary, and may need to reduce the potency of the poison pill in order to convince shareholders to vote in favor of it.

But the proposal contains a critical flaw that weighs against its adoption. Although the shareholder approval mechanism seems beneficial from the perspective of investor protection, in practice it could create significant investor protection concerns. Given shareholder complacency, it may be relatively easy for management to adopt a non-tactical poison pill at an annual meeting. Most retail shareholders would be unlikely to vote at the meeting and large institutional shareholders may be hesitant to go against management for fear of reprisals. Moreover, if a non-tactical poison pill was adopted, the company would be almost certain to have a defense against any hostile takeover bid until the next annual meeting. While shareholders could in theory requisition a meeting to terminate the pill, this would be difficult. First, the regular rules for requisitioning a meeting would apply: a requisitioning holder of five percent of outstanding voting shares would need to require directors to call a meeting. But even if required, directors would still have discretion over the timing of the meeting and the record date and could use this to their advantage. At the meeting itself, the burden of inertia would be against those who wish to remove the poison pill: a majority of shares would have to vote in favor of removing the pill. Moreover, shares held by the bidder and its joint actors (who would be in favor of removing the pill) would be barred from the vote while shares held by insiders and others friendly to management (who
would likely favor keeping the pill) would be permitted to vote.

More generally, some scholars have questioned whether a shareholder vote accurately represents the will of shareholders. For instance, some scholars have argued that shareholder voting is often influenced by political, rather than economic concerns. Accordingly, directors may be able to skew the results of a shareholder vote by investing in high-profile public relations campaigns rather than focusing on fundamental issues like wealth creation. This would be problematic both from the perspective of investor protection as well as efficiency.

Although the investor protection concerns may be sufficient to weigh against the proposal's adoption, it should be noted that the proposal raises other efficiency concerns. In addition to its questionable ability to discipline management, its shareholder vote mechanism effectively endorses the collective bargaining principles of the aggregated private property model. By allowing shareholders to collectively hold out for a higher price, the proposal forces an acquirer to relinquish a greater percentage of the control premium or synergy gains that will result from the transaction. This will lower the hostile acquirer's returns and, in at least some cases, could reduce the likelihood of the hostile takeover being made.

In the end, the shareholder vote proposal falls short of its goal. It sacrifices efficiency in exchange for investor protection but fails to address critical concerns from the investor protection goal it aims to pursue.

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154 See e.g. Lee Harris, "The Politics of Shareholder Voting" (2011) 86 N.Y.U. L. Rev. 1761. But see Lucian Arye Bebchuk, "The Case for Increasing Shareholder Power" (2005) 118 Harv. L. Rev. 833 at 914 (arguing that increased shareholder voting power can discipline management and increase firm value).
B. The Problem with Stakeholders

Given the inadequacy of the shareholder-centric models that have been mentioned, the advisability of an alternate stakeholder model should be addressed. Of course, it would be difficult to implement a stakeholder-centric model through the Commission, given its strong emphasis on shareholder primacy and investor protection. In this regard, some practitioners have discussed moving the regulation of poison pills from securities commissions to the courts.

But such a proposal would raise significant problems in the hostile takeover context, particularly under the stakeholder-centric approach elaborated by the Canadian Supreme Court. From the perspective of wealth maximization, the fiduciary duties standard laid out by the Canadian Supreme Court in Peoples and BCE, courts would not be able to scrutinize director conduct to any significant degree. Assuming that directors are self-interested actors, it would be difficult to ensure that directors are making the best decision to maximize wealth, rather than seeking to entrench themselves under the guise of protecting the interests of other stakeholders. Moreover, while jurisdictions with judicially-administered poison pill regimes, such as Delaware, have incorporated the Unocal enhanced

155 See Re Baffinland Iron Mines Corp. supra note 131 (declining to grant deference to directors based on their corporate fiduciary duties).
156 See generally Dey and Yalden, supra note 1; Vanderpol and Waitzer, supra note 6.
157 See Iacobucci, supra note 35 at 253; Lupa, supra note 35.
158 As previously discussed, the team production theory does not take into account the fact that directors may occasionally be self-interested actors. In normal conditions, the team production theory may produce acceptable outcomes, as directors' interests may be relatively insignificant. Directors, for instance, may have some incentive to not perform efficiently, but this interest is likely to have a minimal effect on their actions. But in a hostile takeover situation, the situation is different: directors are at risk of losing their positions. This can have significant economic and non-economic implications, and will therefore have a substantial effect on directors' decisions.
159 Iacobucci, supra note 35 at 253-54.
scrutiny standard to police director decisions during hostile takeovers, the Canadian system has not adopted such a standard, which increases the possibility of director entrenchment.

Additionally, from the perspective of stakeholder protection, the stakeholder model may not offer measurable benefits during a hostile takeover. In this regard, it is important to frame the issue correctly: the question is not whether social regulation and stakeholder protection is warranted, but how to best bring it about. Most proponents of the stakeholder theory would argue that many stakeholders are in need of greater protection than they hold through contractual negotiations. Moreover, almost all scholars would agree that wealth maximization is not the end goal of society. Instead, non-economic considerations and social policies should play a critical role. Thus, the main concern rests on how these social policies should be achieved: through internal corporate governance, or through external regulation. As advocates of shareholder primacy have argued, external regulation can provide a sufficient mechanism for addressing third-party interests.¹⁶⁰

But as Professor Lee has countered, economic and power imbalances in the law-making process may make it difficult to ensure that third-party interests are given sufficient weight in a system of external regulation. This is undoubtedly a concern, and may merit in favor of considering a more equitable decision-making model in the legislative or regulatory context. However, Professor Lee's arguments may not be applicable to the hostile takeover context. First, it is unclear why directors would be able, and willing, to consider third-party interests when legislators are not able. Directors, like legislators, are elected through a democratic shareholder voting process. As a result, even with an expanded mandate, directors will be likely, either consciously or unconsciously, to continue to focus primarily on

¹⁶⁰ See MacIntosh, supra note 14.
the shareholders. In this regard, directors have a very good reason for this concern: shareholders hold the directors' jobs in their hands and can easily change the status quo through tendering their shares or voting for new directors.

Moreover, to the extent that directors consider third-party interests during a hostile takeover, they will likely be limited to interests that have a significant effect on the corporate operation. The directors, for instance, will likely interface with creditors, suppliers, major customers, and financial institutions with which the corporation has a relationship as their cooperation can be essential to the corporation's continued survival. But other third-parties without voting rights or economic power would be less likely to factor into the directors' decision-making matrix. While some would argue that directors retain their morality and social accountability even in the midst of a takeover, it is unclear why directors would be more likely to consider these underrepresented interests than would politicians. If anything, politicians would be more likely to consider such interests as their decisions would be unlikely to have immediate ramifications on their job security.

C. The Permitted Bid Proposal

In my opinion, structural "permitted bid" requirements would provide the best option for reform. The following excerpt briefly describes the structure of the reform:

A bid would have to include an irrevocable minimum tender condition requiring that more than 50% of the target’s shares held by independent

161 Granted, directors may be better than politicians in one regard: they may be less likely to suffer from the collective action problems to which legislative assemblies are often susceptible. However, the widespread public coverage and interest that hostile takeovers generally create would likely be sufficient to help politicians overcome collective action problems in many cases. See e.g. Nicolas Van Praet, "Quebec’s move to shield Rona from Lowe’s takeover could end badly", Financial Post (10 August 2012), online: Financial Post <http://business.financialpost.com/2012/08/10/quebecs-move-to-shield-rona-from-lowe-s-takeover-could-end-badly/> (discussing the Quebec provincial government's immediate action to combat a hostile takeover of Rona by Lowe's).
shareholders be tendered to the bid. Partial bids would be permitted but would be subject to the same 50% minimum tender condition. If the 50% condition was satisfied, the bidder would be required to extend its offer for an additional 10 days to give shareholders that have not deposited their shares time to deposit them during the extension.\textsuperscript{162}

From the efficiency perspective, the preferred bid proposal would offer substantial advantages over other proposals. In terms of cost-efficiency, the proposal offers an opportunity for shareholders to express their preference by "voting with their feet." In other words, the proposal by-passes the costly and intrusive shareholder meeting requirements imposed by the market mechanism proposal and shareholder vote proposal to allow shareholders to express their preferences directly. The proposal would also minimize intrusive regulatory intervention, which would make it more cost-efficient than the current regime. Moreover, the permitted bid proposal would provide an effective way to avoid shareholder coercion without adopting the inconsistent and questionable normative framework of the aggregate private property model. Allowing any shareholder to tender up to ten days after a successful bid for the same amount and form of consideration would address any concerns that shareholders would tender to a less-than-ideal bid because they are afraid that their shares will subsequently be less liquid and therefore less valuable. If shareholders are unsure about the bid, they could simply wait until the initial bid period expires.\textsuperscript{163}


\textsuperscript{163} Arguably, the proposal does not address one criticism of the current regime: hostile bids can force companies into an auction. But it would be a fallacy to assume that all, or even most, forced auctions are undesirable from an efficiency perspective. They may simply reflect the fact that other entities believe they can run the corporation more efficiently than current management. Thus, while the new rule may not decrease the tendency of a hostile bid
To the extent that markets are not perfectly efficient, the permitted bid proposal would provide additional time - 10 days over the previously required minimum time period - for markets to self-correct. In this regard, the proposal is admittedly subject to criticism. Assuming that independent directors could truly be independent, the independent director reform would be preferable in some cases as it would provide flexibility to address situations in which the market cannot self-correct during the minimum established time period. But the negative effect of this aspect of the proposal could be diminished, such as by increasing the minimum time period during which a bid must remain open. Additionally, the preferred bid proposal would likely create incentives for directors to disseminate new information into the market. This would increase the company's market price and help fend off an opportunistic hostile bid. Thus, the new proposal could diminish the market inefficiency concerns it faces by decreasing the time it takes for markets to self-correct during a hostile bid. In contrast, the independent director proposal requires only passive acceptance by directors. It would not encourage independent directors to increase market efficiency.

Admittedly, the "permitted bid" proposal could have additional negative effects on efficiency. Requiring an acquirer to bid for at least 50 percent of independently-held shares, and any shares tendered within ten days after the conclusion of a successful bid, would undoubtedly increase the cost of acquiring control of a company, which could discourage some hostile bids. For instance, if a bidder currently holds 30 percent of the target company's shares and wants to obtain control of the company through a takeover bid, it would normally need to acquire 20 percent of outstanding shares plus one additional share. Under the to push a company into an auction, it does address the concern that companies will initiate an auction for improper reasons: because of concerns that shareholders will tender to a coercive, but sub-optimal bid.
permitted bid rules, the bidder would be required to bid for at least 50 percent of the independently-held shares, or 35 percent of outstanding shares.

However, in many cases, the effect of the permitted bid tender requirements would be minimal as most bidders own a smaller percentage of outstanding shares. For instance, if a bidder holds five percent of outstanding shares and wants to acquire control, it would need to acquire an additional 45 percent of outstanding shares plus one additional share. Under the permitted bid rules, the bidder would be required to bid for 50 percent of independently-held shares. But given the bidder's share ownership percentage, this would only equate to 47.5 percent of outstanding shares, less than 2.5 percent more than the bidder would otherwise wish to acquire. Moreover, if the five percent bidder wanted to acquire 2/3rds of outstanding shares to effectuate a second-stage squeeze out, it would want to acquire 61.7 percent of outstanding shares, much more than the minimum percentage required under the permitted bid provisions.

In addition, as opposed to the current regime, a permitted bid proposal would create a more predictable system: both bidders and target companies would know the regulatory framework up front and could predict its outcome on the bid. This could reduce any inefficiencies that result from unpredictable outcomes under the current regime.

Moreover, from the standpoint of investor protection, the preferred bid reform would be particularly attractive to the Commission. In addition to its ability to prevent coercive bid tactics, the preferred bid proposal provides a more accurate representation of shareholders' actual preferences. As discussed, both the shareholder vote proposal and the market mechanism proposal suffer from power disparities and structural constraints that lessen the ability of these reforms to protect shareholders. Under the preferred bid proposal, there is no
doubt as to the choice that shareholders wish to make. But most importantly, shareholders can tender their shares without restrictions. Other proposals constrain shareholders' ability to freely tender their shares at least to some extent.

Lastly, the permitted bid proposal would have an additional benefit that weighs in favor of its adoption: it would not require regulators or companies to radically change their governance structures or operating procedures. While disallowing poison pills would at first appear to be a drastic measure, it may not have such a dramatic effect. While the "permitted bid" proposal does reduce directors' flexibility in crafting a response to takeover bids, the content of permitted bid proposal has arguably already become standard market practice as most Canadian poison pills contain "permitted bid" requirements. Therefore, incorporating such provisions into the statutory framework would be unlikely to dramatically change the actions that directors would otherwise have taken. Additionally, securities law regimes have experience with implementing structural takeover bid provisions.

VI. CONCLUSION

Given the various reforms available, it would be advisable to reform Ontario securities regulation to include a structural permitted bid provision. In the context of the hostile takeover bid, a stakeholder-centric model would not be workable and would require a dramatic shift in the regulatory mechanism for overseeing poison pills. In this regard, shareholder-centric, wealth maximization reforms are more in line with the goals of the OSA and also offer a better mechanism for regulating poison pills. But other reforms that have been proposed - particularly the market mechanism proposal, independent director proposal, and shareholder vote proposal - fall short in one way or another. While some reforms do not deliver sufficient efficiency and investor protection benefits in practice, others also suffer
from ideological inconsistencies that result from incorporating a patchwork of different normative corporate theories.

In contrast, the permitted bid proposal provides practical mechanisms for protecting investors and promoting market efficiency in line with the goals of the *OSA*. Additionally, it provides a consistent answer to the two fundamental questions of securities law: what is the purpose of the corporation, and who should determine whether the goals of a corporation are being met, and whether the takeover is the best method for meeting them.
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