Foreign Takeovers of Canadian/Quebec Corporations: How big an issue and what to do about it

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(The opinions expressed in this article are solely those of the author).

The recent offer by US-based Lowes to acquire Rona, occurring as it did in the midst of the Quebec election campaign, has triggered calls for actions to protect the ownership of Rona. Quebec political parties took strong positions against the takeover, ranging from changing corporate laws to pooling funds to acquire a blocking stake in the company (and others). The furor fizzled out as Lowes dropped its offer (for now anyway).

However the issue remains current as an investor seeks to replace the whole board with new members presumably more open than the current board to a sale of the company.

A reminder

For various reasons, some good, some debatable, the Canadian industrial structure is made up of a large number of companies, which, because of their ownership form or federal laws are protected in some ways from foreign or domestic takeovers. Indeed, 17 are Controlled Corporations, 5 are State-owned, 3 are Cooperatives and 2 are Privately Owned. These corporations cannot be taken over without prior arrangement with the present owners.

Then, federal laws control the level of shareholding, foreign or Canadian, which is permissible in various industries: banking, insurance, airlines, and telecommunications. There were 14 corporations thus protected among the 100 largest Canadian companies.

Some 19 companies are subsidiaries of foreign companies.

So, of the largest 100 Canadian companies, based on revenues, only *forty* are widely held; and almost half of them operate in the energy/resources sector, a sector where the Canadian government waxes and wanes when it has to authorize or reject foreign takeovers: no to Potash, maybe to Nexen.

In Quebec, the 100 largest Quebec firms (based on revenues) exhibit an even more protected ownership structure: 8 are State-owned, 15 are entirely private, 8 are cooperatives, 34 are controlled by one shareholder or a group of related shareholders and 17 are subsidiaries of foreign firms. That leaves *only 18 widely held corporations,* including several that are protected by federal laws against foreign takeovers. (See ***A Capitalism of Owners*****,** by Allaire and Firsirotu, 2012).

The issue, in Quebec as in the rest of Canada, has to do with widely held *publicly-traded* companies which have no takeover protection under federal laws. How should a society view, and deal with, the recurrent waves of intense takeover activity?

Admittedly, international and interprovincial merger and acquisitions play a strategic role in fostering the growth, consolidation and geographic expansion of dynamic businesses. That is true for Canadian corporations as it is for foreign-based corporations.

What is unique to Canada and thus to Quebec is the relative ease with which corporation can be taken over here as compared with say in the United States, the relative impotence of Canadian boards in cases of attempted takeovers. In Canada, once a takeover offer is made public, the board members of the target corporation are transformed into virtual auctioneers of the company.

The cause of this untenable situation is rooted in rules set by Canadian securities commissions that govern merger/acquisition.

As far back as 2008, the **Competition Policy Review Panel** (The Wilson Committee) made the following recommendations to the Canadian government:

- Securities commissions should abrogate National Policy 62-202 (Take-over bids - defensive tactics).

- Securities commissions must cease regulating board of director initiatives related to poison pills.
- The courts (rather than securities commissions) should closely oversee directors' obligations related to mergers and acquisitions.
- The Ontario Securities Commission should be the leader among Canadian securities authorities by implementing the changes noted above and by taking the initiative if no collective action is taken before the end of 2008.

These recommendations were not followed up on, with the OSC remaining most reluctant to implement any changes to the current regime.

How important an issue in Quebec

Fortunately, the 50 largest Quebec publicly-traded companies (based on market capitalization), including many of its industrial champions, have capital structures that shelter them from take-over attempts.

No less than 20 are controlled by a single shareholder (or related shareholders). These include Bombardier, Power, CGI, Quebecor, Groupe Jean Coutu, Alimentation Couche Tard, Cogeco, Astral Media, Transcontinental, and others.

In addition, five of these 50 companies are in sectors protected by Canadian laws against foreign takeovers. These include banks, as well as insurance, telecommunications and air transportation companies. Businesses shielded include National Bank, Laurentian Bank, Industrial Alliance, BCE and Air Canada, (Bank of Montreal and Royal Bank, with nominal head offices in Quebec weren't included in the 50).

CN for its part is a special case:

CN's Articles provide that where the total number of voting shares held, beneficially owned, or controlled, directly or indirectly, by any one person together with his or her associates exceeds 15%, no person shall exercise the voting rights attached to the voting shares held, beneficially owned or controlled, directly or

indirectly, by such person or his or her associates. (CN Annual Information Form, February 2012)

*Thus, from this list of the 50 largest corporations, based on market capitalization, there remain **24** that could be the plausible targets of a takeover attempt.*

Eight of these businesses are incorporated under Quebec law and 16 under federal law.

The two following tables identify these businesses:

Widely-held companies incorporated under Quebec law and without protection against takeover	
Companies	**Market capitalization in $ million (as at 5/10/2012)**
Cascades	$451
Cominar (real esate investment trust)	$3,279
Héroux-Devtek	$410
Metro Inc.	$5,659
Quincaillerie Richelieu	$695
Rona Inc.	$1,496
Semafo Inc. (mining company)	$1,208
Uni-Select	$551

Widely-held companies incorporated under federal law and without protection against takeover	
Companies	**Market capitalization in $ million (as at 5/10/2012).**
Aimia Inc. (ex Groupe Aeroplan)	$2,564
Atrium Innovations	$438
CAE Inc.	$2,724
Dollarama Inc.	$4,749
Domtar	$3,333
Genivar (engineering and construction)	$1,147
Gildan Inc.	$3,914
Innergex (renewable energy)	$1,006
Intertape Polymer (products and packaging systems)	$395
MTY (Food group)	$377
Orbite Aluminae (metallurgical alumina extraction)	$499
Osisko (mining corporation)	$3,781
Résolu (forest products)	$1,252
SNC-Lavalin Inc.	$5,745
TransForce Inc. (transport et longistics)	$1,987
Valener (production, transport, storage and distribution of energy).	$696

Several of these companies have institutional shareholders that hold more than 10% of outstanding shares with voting rights. These shareholders could not, even if they wanted, block a take-over. Often, these shareholders are investment funds, so we do not know the duration of their commitment as shareholders, nor how they would respond to an attempted takeover.

It should however be noted that according to the latest SEDAR data, several Quebec companies have large blocks of outstanding shares held by investment

funds with long investment horizons. These include Jarislowski Fraser (Metro 17.88%, Uni-Select 14.9%, SNC-Lavalin 14.37%), the Caisse de Dépôt et Placement (Héroux-Devtek 13.9%, Rona 14.18%, Genivar 14.1%) and the Fonds de Solidarité FTQ (Atrium 16.3%).

All in all, although the issue of takeovers of Quebec companies is significant, the stakes are limited by the fact that so many large Quebec businesses are controlled by a single shareholder or a group of related shareholders, or are subject to Canadian laws that protect businesses in certain sectors against foreign takeovers.

What should be done?

So how could the Quebec government intervene to maintain domestic ownership of certain businesses if it judges that it should do so?

1. **Changing Quebec law or the mandate of the Autorité des Marchés Financiers**

Quebec could change the Quebec Companies Act to include new clauses giving the boards authority, or even imposing the obligation, to consider all stakeholders when evaluating the advisability of selling the company.

It should first clarify the meaning of Article 119 of the Quebec Business Corporations Act:

Consequently, in the exercise of their functions, the directors are ***duty bound to the corporation*** *to act with prudence and diligence, honesty and loyalty and* ***in the interest*** *of the corporation*. (Emphasis added).

Similarly, article 122 of the Canada Business Corporations Act stipulates that:

*Every director and officer of a corporation in exercising their powers and discharging their duties shall (*a*) act honestly and in good faith with a view to the* ***best interests of the corporation****;* (Emphasis added)

In two important judgments (People's and BCE) the Supreme Court of Canada interpreted the meaning of article 122. In People's v. Wise, the Supreme Court

stated: *We accept as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, inter alia, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment.*
No less than 35 US states have adopted statutes that authorize defensive measures, ranging from poison pills, the right of boards of directors to take into account all stakeholders, the prohibition, for between three and five years, to merge the assets of the acquiring company with those of the target. Some states require that the purchase offer be accepted by more than half, or even two thirds, of shareholders, but exclude those held by the company that made the offer (a super majority).

For example New York state statutes force board members, when they are evaluating a takeover offer, to make a "business decision" in *"the short and long-term interests of the corporation and its shareholders, and considering the short and long-term effects on active employees, retired employees, the company's clients and creditors, as well as on the ability of the company to supply goods, services, job opportunities and to contribute to the community in which the company does business."*

Nothing in Quebec or Canadian law would prevent board members from interpreting their fiduciary responsibilities that way *except for rules established by Canadian securities commissions in matters related to mergers and acquisitions.*

The Quebec government could direct the *Autorité des Marchés Financiers* (or modify its mandate) to adjust its rules to give boards of directors more authority and latitude in the evaluation of takeover offers. These could include the right to use effective defensive measures, or to decline an offer without being forced to submit it to a shareholder vote. Such authority must naturally be exercised reasonably and be subject to the jurisdiction of competent courts.

But Quebec's Autorité des Marchés Financiers is part of the Canadian Securities Administrators, the Canadian association which has been created to coordinate and standardize regulations nationwide. The possibility of the AMF going it alone

would only increase the appetite of those still salivating for a national securities commission.

Of course, none of these moves would prevent takeovers in situations where t*he board itself approved the transaction.* If RONA's board had approved Lowe's offer nothing proposed here would have prevented the transaction from going ahead. Investment Canada could have blocked the transaction invoking that it fails to bring a net advantage to Canada. However such a call would have been unlikely.

Thus the legislative approach open to Quebec offers only a *partial solution* open to a variety of risks. **The real challenge consists of bringing together Canadian securities commissions together so they can review their roles.**

2. **Create a Quebec fund to block takeovers**

The general idea of this approach, as it as sketched during the Quebec election campaign, would be to create a Quebec fund made up of contributions from the Caisse de Dépot et Placement, Investissement Quebec and other provincial institutions. These funds would be used to buy enough shares in vulnerable businesses to block takeover attempts.

This type of Quebec investment fund could obviously not wait until an offer was made public before acting. Indeed, as soon as a takeover offer is made public, share prices tend to spike. As a result, if the fund waits for the offer to become public, it would end up paying top price for the shares. Then as soon as financial markets realized that the transaction would not occur, because the Quebec fund has acquired a blocking number of shares, the price of the shares would fall rapidly, inflicting dramatic losses on the Quebec fund!

To act preemptively, the Quebec fund would need to prioritize the most vulnerable businesses based on economic and social impact criteria, a most delicate and highly political task.

In addition, as soon as it became public that the Quebec fund had taken a significant stake in the company, (the fund would be required to disclose any participation that represented more than 10% of outstanding shares), the firm

would be faced by a flight of capital by disappointed shareholders as well as the manoeuvers of speculative funds to take advantage of the newly created fund's commitment to the company.

It's important to remember that *the Caisse de Dépôt et de Placement is not the government's private equity fund.*

That said, the Caisse may (as it already does, without a government mandate and based on its investment criteria and strategy) take significant long-term positions in Quebec businesses that offer attractive growth and profit potential, and support them financially in their development. Several businesses identified in the two previous tables could meet the Caisse's criteria, should it decide to further pursue this approach.

Conclusion

Quebec businesses at risk of foreign takeovers are easy to identify and fairly few in number. The most promising avenue to protect them, as well as Canadian companies elsewhere in Canada, from hostile takeovers is through actions by the securities commissions. Despite forceful recommendations by the **Competition Policy Review Panel** to the Ontario Securities Commission in 2008, nothing (or almost nothing) has changed. Quebec's Autorité des Marchés Financiers should thus assume a leadership role on this issue. The time is right.

The Quebec government for its part could clarify certain part of the current law, perhaps adding some new elements to make Quebec an attractive jurisdiction for companies (authority of the boards, etc.). But most effective of all, the Quebec government should ask the Autorité des Marchés Financiers to change its regulations to bring them in conformity with the letter and spirit of the Quebec Business Corporations Act.

Changes in the AMF's regulations to give boards more authority during hostile takeover situations could become operational when and if a certain number of other provincial securities commissions moved in the same direction.

Finally, the large Quebec investment funds should fully exercise their roles as long-term investors in Quebec businesses.