Boards should decide takeovers

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(The author expresses personal opinions)

In an opinion piece published in the ***Financial Post*** on May 6th, (*Shareholders should decide takeovers),* Mr. Philip Anisman responds to my piece published in the ***Financial Post*** of April 30th (*Canada needs a new takeover regime*).
Mr. Anisman recycles the key arguments of “market discipline” and boards having to dedicate themselves to the singular goal of “maximizing shareholder value” when assessing an unsolicited offer to buy the company.

Of course, he has to acknowledge that “*the fiduciary standard adopted by the Supreme Court of Canada in its BCE decision would enable such directors’ decisions* [i.e. preventing a takeover bid]. *By encompassing the interests of all stakeholders within directors’ fiduciary duties, the Supreme Court has, in effect, adopted the substance of many U.S. state anti-takeover laws, allowing directors to determine whether the interests of stakeholders other than shareholders should prevail in any given case. Like Mr. Allaire, the BCE decision would permit directors to just say “no” to a takeover bid and would limit the unique market discipline provided by takeover bids. Whatever the merits of this position under corporate law, it does not govern the takeover bid provisions in the securities laws administered by our securities regulators.*

But that is my very point. Shouldn’t the provincial securities regulators adopt a regime for takeovers which is consistent with Supreme Court decisions? Is it appropriate for securities regulators to place themselves above the Supreme Court? Is it not possible that the long-term interest of

the company, not “maximizing shareholder value”, calls for the rejection of a particular hostile bid?
Why have many U.S. states adopted anti-takeover laws? Why should Canada, with a more vulnerable economy and a smaller industrial base, be more open than the U.S. to the vagaries of unchecked takeover games?
Carol Liao, having interviewed 31 Canadian legal practitioners, reports that, in their view, “*directors are in the best position to unlock share value, as it is their fiduciary duty in the best interests of the corporation, but directors are being denied the proper tools to do so”*. (“A Canadian Model of Corporate Governance: Insights from Canada’s Leading Legal Practitioners”, Carol Liao, 2013)

Mr. Anisman refers to one study purporting to show the discounting effect of “poison pills” on share value. Well, in this area, Academia is very uncertain as studies contradict each other and results are too contingent on methodology, time frame, samples, etc..
But a comparison of two decades of M&A activity in the U.S., the 1980s- a period of unbridled takeovers- and the 1990s- a period subsequent to the adoption by some 30 states of laws granting boards more power in dealing with hostile takeovers- provides interesting data, as follows:

Statistical facts about U.S. takeovers

	1980-1989	1990-1999
Number of M&A events	**1,232**	**2,582**
Percent successful	**77.5%**	**88.0%**
Percent hostile	**10.8%**	**3.9%**
Actual offer premium	**48.4%**	**54.4%**
Abnormal return premium	**16.3%**	**23.9%**

(Source: Gaspar, Massa, and Matos, 2005)

It would appear that the changes in U.S. state laws have indeed led to far fewer hostile takeovers; but the rate of successful takeovers actually increased and shareholders received a substantially better offer for their shares. ***Boards of directors with enhanced powers have extracted much better deals for their shareholders.***

Mr. Anisman writes: *Referring to the acquisition of shares of a target corporation by arbitrageurs and hedge funds after the announcement of a takeover bid, Mr. Allaire argues, in effect, that the shareholders protected by the regulators' approach to poison pills are not deserving of this protection as they are short-term shareholders. He fails to recognize, however, that the shares they purchase are sold to them by other shareholders who wish to obtain the increased price that usually follows the announcement of a takeover bid. These shareholders' determination to sell reflects their acceptance of the price generated by the bid, rather than continuing with the target corporation, and can be viewed as supporting the bid.*

But there are good reasons in the current state of the investment and takeover market for this phenomenon to occur:

- Elementary financial calculus would incite an investment fund (mutual fund, pension fund, etc.) to sell its shares at the going price soon after the takeover offer; if the takeover bid were to fail (or be blocked by governmental bodies), the fund could buy back the stock at the pre-bid price and yet post a nice return boosting its yearly performance. Suppose that a fund has bought shares at $100 and held them for the last three years when a takeover bid is made at a price of $130. Immediately after the announcement, the price of the share climbs, say, to $125. The fund could hold on to the shares until completion of the transaction at $130 in, say, six months (incurring the risk that the bid fails and the share price drops back to $100). For that fund, selling into the market at $125 means a return of 7.72% a year; holding on to the shares for another six months and getting $130 for them brings up the return to 7.78% a year, a negligible increase in yield to take the risk of the bid failing and the yield then dropping to 0%. The current shareholders at the time the bid is made public know, that given Canadian regulations, there is a high probability that the takeover bid will be successful, that their *individual* interest is to sell at the price approximating the bid price even if they believe that it is not in the long-term interest of the company.

- For the arbitrage funds and like-minded "investors", the calculus is far different. Buying the shares at $125 and holding them for six months generates a yearly yield of 8% if the bid closes at $130. That is the reward for taking the risk that the takeover bid will not be successful; of course, there is also the possibility that a higher bid price might be forthcoming and thus push the yield to arbitrageurs even higher.

It would be self-defeating, as is proposed by the CSA and Mr. Anisman, to grant to these new "shareholders" the ultimate decision of whether the company should be sold or whether a poison pill should stay in place! The whole point of their actions is to get these companies sold out at the best price and as quickly as possible. That's how they make their money!

Indeed Canada needs a new takeover regime!