The Sale of Potash: Canadian Governance and Hostile Takeovers

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The Canadian government blocked the company BHP-Billiton from acquiring Potash Corp, giving the would-be acquirer 30 days to improve on its offer.

Why, after Alcan, Falconbridge, Inco and others would the Canadian government even consider approving this deal; because Canada, it seems, is easily intimidated when it comes to the rough game of international competition. The Canadian government is rife with free-market advocates who, in the opinion of several pundits, committed the horrible sin of "'political expediency" by blocking the takeover of Potash.

These pundits, of all stripes, came out of the woodwork to remind us all that shareholders are the "owners" of the company, that Canadian firms also make acquisitions abroad (Quick: name the last successful "hostile" takeover abroad by a Canadian company). We are also sternly warned about the damage to Canada's reputation as a destination for foreign investments etc., should the Government of Canada block a takeover by a foreign company. In the course of the next thirty days, commentators will make their case again, leaning hard on the "conservative" principles espoused by the Harper government.

[1] The opinions expressed in this article are those of the author and not necessarily those of the Institute or of its board of directors.

“*If you’re a conservative, you must support the right of a company’s shareholders to dispose of their assets as they see fit, untrammelled by government intervention.*

If you’re a conservative, you believe investment dollars should flow to where they’re wanted, and that protecting Potash Corp. from the market would endanger Canadian investors looking to acquire assets abroad.”

(John Ibbitson, Globe and Mail, November 3rd 2010)

The argument about shareholder sovereignty sounds particularly hollow. It seems to be based on a residual belief that share holding has remained what it used to be: a fairly stable group of people and funds who believe in the prospects of a company. Well, average holding period of shares has dropped *under one year; in the bizarre world of short sellers, stock derivatives, day-traders, black pools, high-speed traders, flash orders, speculators of all stripes, etc., etc.,* the notion that whoever happens to hold shares of a company on a particular day is the legitimate “owner” of that company seems strange. In all decent societies, *tourists don’t vote, gamblers don’t own the casino!*

In the hours and days after (sometimes before) a bid to acquire a company has been announced, a massive volume of transactions occurs with the net result that a substantial proportion of the shares ends up in the hands of hedge funds and arbitrage funds. They, and other speculators, are supposed to be treated as the hallowed *owners of the company holding a legitimate right to decide on its fate and future!*

Potash v. Casey’s

The fact is that the largest economy in the world with the reputation as one of the most market friendly, the Unites States, has a far more restrictive set of laws giving the board of directors some formidable powers to repel hostile bidders. Contrast BHP-Billiton’s hostile bid for Potash Corporation with ***Alimentation Couche Tard (ACT)***’s bitter fight to acquire ***Casey’s***, an American operator of convenience stores, legally domiciled in Iowa.

Clearly, ACT was not bidding to acquire some company in a sensitive industry. The deal would not affect the national security of the USA, nor would it put in foreign

hands a large chunk of its non-renewable natural resources. It was all about convenience stores. Yet, the Iowa Business Corporation Act makes it virtually impossible for a would-be acquirer to succeed if the board of directors wants to resist the takeover. Shareholders have very little say in the process.

The Iowa Business Corporation Act (and it is also the case in several other state jurisdictions) provides the board of directors with the following means of fighting a hostile bid:

- A Poison Pill Statute, *which expressly permits directors to adopt "rights plans" with almost unfettered discretion as to their terms*;
- A Business Combination Statute, *which basically imposes a three-year moratorium on the acquirer combining or selling assets of the target company; this statute prevents the acquirer from extracting any economic benefit from the acquisition for a period of three years;*
- An Other Constituencies Statute, *which permits a board of directors to consider, and even favour, other constituencies, the corporation's employees, suppliers, customers and creditors and the communities in which the corporation operates;*

Obviously, ACT would not succeed in its takeover attempt unless it managed to get a totally new slate of board members elected or successfully challenged these statutes. Eventually, and not surprisingly, ACT lost the battle.

The Canadian securities commissions

In the USA, governments do not intervene in individual transactions but have created a legal framework (in some 30 states) that gives the board of directors broad powers to reject hostile attempts at taking over a company. State laws govern how a board may act when challenged by a hostile takeover attempt. The U.S. securities commissions make sure not to step in front of the laws of the various states in these matters.

In Canada, the government has to get involved in foreign acquisitions because Canadian securities commissions, adopting what they believed to be the modern, shareholder-friendly way, have emasculated boards of directors of any power

when challenged by a hostile takeover, actually turning the board into a mere sales agent.

National Policy 62-202, adopted in August 1997, states in its introduction:

> *"The Canadian securities regulatory authorities recognize that take-over bids play an important role in the economy by acting as a discipline on corporate management and as a means of reallocating economic resources to their best uses. In considering the merits of a take-over bid, there is a possibility that the interests of management of the target company will differ from those of its shareholders."*

There is no mention in this policy of other stakeholders or of the board "acting in the best interest of the corporation". The policy serves one party only: the shareholders.

Canadian corporations cannot adopt long-lived poison pills (Poison pills in Canada have a short life and serve only to give time to the board to bargain for a better price), do not have staggered boards (i.e. whereby only a third of the board is elected each year, a formidable defence against hostile takeover as the bidder cannot replace quickly a majority of board members)[2].

The policy of the Canadian securities commissions was adopted in another age, before the advent of change-of-control compensation packages which often align management more closely to a bidder than is desirable. It was also adopted for a universe of shareholding that has largely vanished.

[2] *By the way, BHP-Billiton has a staggered board, which it says it will re-consider in 2011! Also, it may come as a shock to some Canadian pundits but the government of Australia may well block the acquisition of the Australian Stock Exchange by the Singapore Exchange, even though both entities would remain autonomous and would continue to be regulated by the same agencies.*

The Canadian law

National Policy 62-202 is strangely deviant from the corporate business law of Canada. The Canadian Business Corporation Act, *which is the law*, states clearly in section 122.1:

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)

And the Supreme Court of Canada, which interprets the law, has made clear in two recent judgments the meaning of *the best interests of the corporation:*

*"It is a duty to act in the best interests of the corporation. **Often the interests of shareholders and stakeholders are co-extensive with the interests of the corporation**. **But if they conflict, the directors' duty is clear — it is to the corporation**" ...*

*"In considering **what is in the best interests of the corporation**, directors may look to the interests of, inter alia, shareholders, employees, creditors, consumers, governments and the environment to inform their decisions. "* (Supreme Court of Canada in BCE v. Debenture holders, emphasis added).

Where does it state in the law of the land that the single role of a board of directors is to cater to the (short-term) interests of shareholders; where does it state that a company may be taken over whenever some acquirer has the will and the wherewithal to do so, that the board cannot *just say no* if, in its business judgment, the sale of the company is not in the best interest of the corporation.

Thus, in Canada, we have the law instructing board members about their duty to consider the best interests of the corporation, including those of several stakeholders other than the shareholders. But governments empower securities commissions to dictate what is legal and proper for a board of directors in case of an attempt to take over their company.

It is time for Canadian securities commissions to bring their policies and rulings in sync with Canadian jurisprudence and the contemporary reality of shareholding, and give the board some power *to just say no* to a hostile bid which, in their judgement, is not in the long-term interest of the company.

If the Canadian securities commissions really want to give legitimate shareholders the right to decide the fate of a publicly listed corporation, it should support the proposal put forward by the IGOPP since 2006 that *the right to vote be acquired only after a one-year holding period.*

That proposal seemed radical when put forward in 2006; but now, it appears tame and essential. A prestigious group of 30 executives and academics assembled by the ***Aspen Institute*** to propose remedies for the chronic short-termism of American corporations offered the following suggestion, among others:

- *In exchange for enhancing shareholder participation rights, consider adopting minimum holding periods or time-based vesting, along the lines of the one-year holding period... (Overcoming Short-termism,* Aspen Institute, December 15th 2009)

Indeed, the SEC has now adopted Rule 14A-11 on proxy access, which comes into effect on November 15th 2010, whereby shareholders owning at least 3% of voting shares for a period of *at least three years*, may nominate candidates for board seats. The significant aspect of this rule is that it grants different rights to shareholders *as a function of the holding period.*

This proposal, which in Canada would require a minor amendment to the Canadian Business Corporation Act, combined with the requirement that a hostile bid be submitted to a vote of the shareholders, would at least put the decision in the hands of those shareholders who have shown a *modicum* of loyalty and commitment to the company. Of course, ironically but appropriately, the larger the percentage of the shares held by speculators and other transient funds, the larger the percentage of the votes which would be in the hands of stable and loyal shareholders.

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