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# Hostile takeovers: Why Canada shouldn't move to U.S.-style rules

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I am an unabashed capitalist. With apologies to Winston Churchill, I believe capitalism is the worst economic system, except for all the others that have been tried. So let me offer a capitalist's take on the proposed new rules dealing with how companies can protect themselves against hostile takeover bids.

These bids are always controversial. They inevitably lead to debate about the vulnerability of Canadian companies and the "hollowing out" of corporate Canada. But the rules of the M&A game are actually fairly straightforward. If a friendly approach by a potential buyer is rebuffed by a target company, the buyer's only way forward is to launch a takeover bid directly to the target's shareholders.

In Canada, boards faced with a hostile bid can use a shareholder rights plan – often called a poison pill – and other defensive tactics to buy time and force a bidder to remove some of the coercive elements of its bid. But a company can't play defence forever: Canadian courts almost always conclude that poison pills be removed after they have served their primary purpose, which is to provide the target board with sufficient time to evaluate competing bids or other alternatives.

As a result, shareholders of Canadian companies are ultimately given the opportunity to vote on the deal, albeit with a recommendation for or against the bid from the board.

The new rules, proposed by the Canadian Securities Administrators, would provide boards with tools to delay the consideration of a bid, but ultimately leave the final decision with shareholders. The new rules also put a 90-day limit on how long poison pills may remain in place absent shareholder approval. This is a sensible approach.

A competing proposal put forth by Quebec's securities regulator goes further by creating a framework that would largely defer to the judgment of the target company's board. Boards would be able to "just say no" to an unwanted bidder by keeping the poison pill in place indefinitely.

Quebec's proposed approach is a natural extension of the province's reaction to last year's unwelcome takeover bid for Rona by Lowe's. It is also consistent with the U.S. approach, which permits greater use of defensive tactics.

In the United States, a board faced with an unsolicited bid can usually keep a poison pill in place long enough to make the bid disappear. The bidder can then choose to pursue a lengthy proxy fight to replace the board or persuade shareholders to pressure the board to change its mind and negotiate.

Canada's takeover rules are clearly more bidder-friendly and, to my mind, more enlightened. Regulators, directors and management teams need to recognize that the sale of a corporation, whether public or private, should be determined by its owners.

There is nothing wrong with a board's use of defensive tactics to prolong a hostile bidding situation in order to evaluate alternatives. It is also entirely appropriate for target boards to recommend voting against a proposed takeover bid. In fact, they can even go further by lobbying shareholders to vote against the bid and by calling the bidder an opportunist – or other names.

Where I take issue with the U.S. approach (and potentially Quebec's) is that it often deprives the owners of the business of the final say.

I have participated in many board meetings dealing with takeovers over the years. I have learned that even well-meaning directors have their biases. Like most people they crave power, prestige and, in their case, the regular cheque that comes with a board seat.

As a shareholder, I defer to their business judgment on most matters. However, when it comes to whether to sell, I insist on making that decision for myself. Even if directors are well-intentioned, it simply isn't their place to make that call.

Quebec may ultimately decide to go its own way. But if it does, the rest of Canada shouldn't follow suit.

The United States has the benefit of having the world's largest capital markets and is home to many of the world's best companies. Like it or not, investors need to be there.

Canada isn't quite as lucky. As a country that needs foreign capital to develop certain industries, we should keep this in mind. For capital tends to move away from places that are perceived as being hostile toward those where it feels welcomed and appreciated.