

Directors' Duties in M&A Context

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Overview

- Basic Duties.
- Shareholders and Other Stakeholders.
- Alternatives Analysis.
- Reasonable Defences.
- Business Judgment Rule.
- Special Committees.

Directors' Duties

- The CBCA provides that "the directors shall manage, or supervise the management of, the business and affairs of a corporation".
- 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 (Fiduciary Duty).
 - (b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances (Duty of Care).
- Duty of Care - objective standard.
- "in comparable circumstances" reference requires the context in which a decision is made to be taken into account.

Fiduciary Duty

- Avoid conflicts of interest with the corporation.
- Avoid abusing their position to gain personal benefit.
- Serve the corporation selflessly, honestly and loyally.
- 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.
- It is a broad, contextual concept.
- It is not confined to short-term profit or share value.
- Where the corporation is an ongoing concern, it looks to the long term interests of the corporation.

Fiduciary Duty - treat stakeholders equitably and fairly - the responsible corporate citizen

- The cases on oppression, taken as a whole, confirm that the duty of the directors to act in the best interests of the corporation comprehends a duty to treat individual stakeholders affected by corporate actions equitably and fairly.
- There are no absolute rules.
- The question is whether, in all the circumstances, the directors acted in the best interests of the corporation, having regard to all relevant considerations, including, but not confined to, the need to treat affected stakeholders in a fair manner, commensurate with the corporation's duties as a responsible corporate citizen.

Fiduciary Duty - other stakeholders

- Consider the impact of corporate decisions on shareholders or particular groups of stakeholders.
 - Shareholders
 - Employees
 - Suppliers
 - Creditors
 - Consumers
 - Governments
 - Environment
- The corporation and shareholders are entitled to maximize profit and share value, to be sure, but not by treating individual stakeholders unfairly. Fair treatment - the central theme running through the oppression jurisprudence - is most fundamentally what stakeholders are entitled to "reasonably expect".

Reasonable Expectations

Factors that are useful in determining whether a reasonable expectation exists include:

- general commercial practice;
- the nature of the corporation;
- the relationship between the parties;
- past practice (can change for valid commercial reasons);
- steps the claimant could have taken to protect itself;
- representations and agreements (prospectuses, promotional material and other communications); and
- the fair resolution of conflicting interests between corporate stakeholders.

Practice?

- When engaging stakeholders, the board of directors should pay attention to establishing the stakeholders' reasonable expectations.
- Boards should consider various stakeholders that may be impacted by a transaction.
- Boards should consider the reasonable expectations of these stakeholders when considering transactions.
- Consider various balancing alternatives.
- Business judgment rule important.
- Special committee composition – consider independence relative to all stakeholders.
- Advisors - consider independence relative to all stakeholders.
- Shareholders' reasonable expectations as stakeholders – carefully consider any decision to move away from maximizing shareholder value.

***Revlon* not followed in BCE SCC Decision**

- *Revlon* line of cases has not displaced the fundamental rule that the duty of the directors cannot be confined to particular priority rules, but is rather a function of business judgment of what is in the best interests of the corporation, in the particular situation it faces.
- Declined opportunity to confirm proposition that shareholder interests always prevail as in *Revlon*.
- BCE was a situation where corporation "in play".

Maple Leaf Foods Inc. v. Schneider Corp., 1998 **Ontario Court of Appeal**

- Change of control situation - competing takeover bids for common shares.
- *Revlon* decision (Delaware) stands for the proposition that if a company is up for sale, the directors have an obligation to conduct an auction of the company's shares.
- *Revlon* is not the law in Canada.

Change of Control Situations

- An auction need not be held every time there is a change of control of a company or a potential change of control.
- "In play"?
- An auction is an appropriate mechanism to ensure that the board of a target company achieves the best value reasonably available to shareholders in the circumstances.
- "BCE facing certain takeover, acted reasonably to create a competitive bidding process". (Note: Court still applied stakeholder analysis.)
- Concept of "a deliberately conceived corporate plan" vs. immediate transaction gain.

Change of Control Situations

- Consider the various mechanisms of determining the availability of alternatives, and advice on their pros and cons in the circumstances:
 - Full public auction.
 - Quiet auction - targeted invitees.
 - Direct negotiations.
 - Status quo

Reasonable Defensive Measures

- NP 62-202 – Securities Commissions vs. Courts.
- Shareholder ability to respond.
- Shareholder Rights Plans.
- September 2014 CSA Proposals to amend Takeover Bid Rules.
- Objective to rebalance current dynamics between hostile bidders and target boards.
 - Bids open for a minimum of 120 days.
 - Target board may waive minimum period to not less than 35 days.
 - Mandatory minimum tender condition of 50%.
 - Mandatory 10 day extension on take-up and pay.

***Kerr v. Danier Leather Inc.*, 2007 Supreme Court of Canada**

- Business judgment rule confirmed by Supreme Court of Canada in the case of "business decisions".
- The court looks to see that the directors made a reasonable decision not a perfect decision.
- Provided that the decision taken is within a range of reasonableness, the court ought not to substitute its opinion for that of the board.
- As long as the directors have selected one of several reasonable alternative, deference is accorded to the board's decision.

Business Judgment Rule in Practice

- Process issues important.
- Proper advice obtained - legal/financial/engineering/other?
 - Fairness opinions.
 - Fees (OSC comments in *Hudbay*).
- Reasonable reliance.
- Decision-makers - special committee required?
- Independence issues.
- Decision-making process - time/discussion/analysis.
- Alternatives canvassed and considered.
- Documenting process to show evidence of "business judgment".

Special Committees

- The use of a Special Committee is usually the most effective means of addressing conflicts and obtaining protection of the business judgment rule for the Board's decisions.
- ***CW Shareholding v. WIC Western International Communications (OCJ).***
 - President & CEO should not have been a member of the Special Committee.
 - Special Committee in fact conducted itself to fulfill duties.
- ***Pente Investment Management v. Schneider Corp. (Ont. CA).***
 - President & CEO conducted negotiations.
 - Benefits – Knowledge of company, guided by advisors.
 - Reported to Special Committee that made final decisions/gave directives.
 - Special Committee in fact conducted itself to fulfill duties.

OSC – Interested Party Situations – Practice Guidance

- It is good practice for negotiations for a transaction involving an interested party to be carried out by or reviewed and reported upon by a special committee of disinterested directors.
- A special committee should, in our view, include only directors who are independent from the interested party.
- While a special committee may invite non-independent board members and other persons possessing specialized knowledge to meet with, provide information to, and carry out instructions from the committee, in our view non-independent persons should not be present at or participate in the decision-making deliberations of the special committee.

Reliance on Management

- In managing and supervising the management of the business and affairs of the Corporation, the directors are entitled to rely on the honesty and competence of senior management.
- However, directors of a target board, or alternatively, the Special Committee must supervise management to the extent reasonably necessary under the circumstances.
- A total prohibition on management's involvement with potential bidders is neither desirable nor practical.
- The Corporation should exercise caution in delegating responsibility to management for dealing with proponents of an unsolicited acquisition proposal or other entities with whom the corporation may engage in an alternative transaction.
- It is usually preferable that a Special Committee have oversight for the process in order to ensure that there are appropriate safeguards in the decision-making process.
- However, the Board, with the advice and recommendations of the Special Committee, retains the ultimate authority to recommend acceptance or rejection of an offer or transaction.

Thank you.