

**THE ROLE OF A BOARD OF DIRECTORS IN
RESPONDING TO AN UNSOLICITED TAKEOVER BID**

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ABSTRACT

The proliferation in the use of the "unsolicited takeover bid" as a means of acquiring corporate control has had profound implications, especially on large publicly traded companies.

Although much has been written about the efficacy of takeover bids advancing shareholders' interests and economic prosperity in North America, surprisingly, opinions on this topic remain divisive. What is even more interesting is the diversity of opinions held with respect to directors' obligations when responding to an unsolicited takeover bid.

What is the "appropriate role" of a board of directors when their company becomes the subject of an unsolicited takeover bid? In the execution of their duties and obligations to manage the business and affairs of a company, we are told that directors are in part, required to act honestly and in good faith in promoting the best interests of the company. Much of the discussion in this paper will be confined to how this phrase, "the best interests of the

company" might be interpreted in the context of an unsolicited takeover bid. What are the constituent elements that make up "the company"? Which interests should be construed as being in the company's best interests? To whom are the directors' duties and obligations owed in endeavouring to promote the best interests of the company?

In the conclusion of this thesis, a theory has been advanced based on the notion of reasonable shareholders' expectations and legitimate shareholders' interests, as a possible approach to understanding the correct meaning of the phrase, "the best interests of the company" and from that, the role directors are to play when confronted with an unsolicited takeover bid for their company.

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CHAPTER ONE

INTRODUCTION

Use of the "unsolicited takeover bid" as a viable means for acquiring corporate control in North America, is a relatively novel business tactic, coming into its own around 1960. ¹ Changes in corporate control prior to this time, occurred chiefly through proxy battles. ² By the 1970s takeover bids had begun to be used more and more frequently as the corporate business community recognized their utility and more importantly, their cost effectiveness. ³ It was not until the 1980s however, that the use of takeover bids truly

¹ M. Borrelli, M. Marr & S. Young, "A Level Playing Field: Regulating Tender-Offers in Friendly versus Hostile Takeovers" (1989) 42 Arkansas L. Rev. 887 at 888; M. R. Gillen, "Proposed Changes To Provincial Takeover Bid Legislation: Deterrence Without Protection" (1991) U.B.C.L. Rev. 129 at 130; J. H. Farrar, "Business Judgment And Defensive Tactics In Hostile Takeover Bids" (1989) 15 Can. Bus. L. J. 15 at 15-16.

² Borrelli, supra, note 1 at 888; Farrar, supra, note 1 at 16. Changes in corporate control can also be achieved through other means, such as mergers or the sale of corporate assets, see M. J. Keliher, "Anti-Takeover Measures - What Standard Should Be Used To Evaluate Them?" (1988) 25 Houston L. Rev. 419.

³ Borrelli, supra, note 1 at 888.

began to proliferate at a tremendous pace.⁴ Mid-way through that decade the volume and value of equity and debt exchanged in these transactions reached staggering proportions in the United States,⁵ with comparatively equal vigour occurring within Canada. It has been said that, "[t]he dollar value of mergers in Canada from 1975-1979, adjusted for the smaller size of the Canadian economy, was five times as large as the value of mergers in the United States. From 1980-1985, the value of Canadian mergers was two-and-a-half times as large as the comparable value for the United States."⁶ Frank Iacobucci commented that the extent and publicity attended these events made even the most casual observer aware of the spectacular heights unsolicited takeover bid had achieved.⁷ Abraham Tarasosky has describes the use of takeovers, "... as

⁴ H. L. Pitt, "On The Precipice: A Reexamination Of Directors' Fiduciary Duties In The Context Of Hostile Acquisitions" (1990) 15 Del. J. of Corp. L. 811 at 812-13.

⁵ W. Adams & J. Brock, "Merger-Mania: An Empirical Critique" in L. McKee, ed., Hostile Takeovers Issues In Public And Corporate Policy (New York: Praeger, 1989) 33; M. Lipton & A. R. Brownstein, "Takeover Responses and Directors' Responsibilities-An Update" (1985) Bus. Lawyer 1403.

⁶ P. Dey & R. Yalden, "Keeping The Playing Field Level: Poison Pills And Directors' Fiduciary Duties In Canadian Take-Over Law" (1991) 17 Can. Bus. L. J. 252 at 262, citing D. DeMott, "Comparative Dimensions of Takeover Regulations" (1987) 65 Wash. U.L.Q. 69 at 81. See generally J. G. MacIntosh, "Poison Pills In Canada: A Reply To Dey And Yalden" (1991) 17 Can. Bus. L. J. 323.

⁷ "Planning And Implementing Defences To Take-Over Bids: The Directors' Role" (1980-81) 5 Can. Bus. L. J. 131 at 132. See J. G. Howard, "Takeover Defences: A Reappraisal" (1990) 24 U.B.C. L. Rev. 53.

one of the most striking features of the course of economic events in North America and Western Europe since the early 1980s." ⁸ John H. Hickman of the Globe & Mail, in his book review of Merchants of Debt: KKR and the Mortgaging of American Business, aptly described the "merger mania" of the 1980s, as "casino capitalism". 8(a)

Although once regarded within the business community as ethically inappropriate, ⁹ the unsolicited takeover bid has become the most common type of transactions in corporate control situations in the United States, Canada, Australia, New Zealand and the U.K. ¹⁰ Albeit somewhat diminished from its heyday of the late 1980s, it is still appropriate to describe the present trend of "the unsolicited takeover bids", as one of continual activity. ¹¹

⁸ A. Tarasosky & R. Corvari, Corporate Mergers and Acquisitions: Evidence on Profitability, (Ottawa: Economic Council of Canada, 1991) at ix. See also The Economist, "Takeovers in Europe expected to pick up under single market" The Globe & Mail (20 July 1992) B 5.

8(a) "Goodbye, leverage takeovers; hello corporate governance" The Globe & Mail (6 June 1992) B 21.

⁹ Borrelli, supra, note 1 at 888.

¹⁰ Farrar, supra, note 1 at 16.

¹¹ See S. Beck's comments in the Ontario Securities Commission 1989 Annual Report at 2; Dey, supra, note 6 at 262; Howard, supra, note 7 at 54; S. Feschuk, "Analyst sees zig-zag decade ahead" The Globe & Mail (9 May 1992) B 5.

The vast majority of corporate control acquisitions are negotiated business transactions, although with respect to public companies there is typically some element of hostility.¹²

The term takeover is often used interchangeably with the term merger. A takeover is however, more commonly understood to mean the premeditated and unsolicited acquisition of shares of a company (the "target") to the extent that control over the target passes to the purchaser of those shares (the "offeror"). A merger on the other hand, implies consensual negotiations, whereby the companies involved combined to form a single new entity.¹³

Generally speaking, a takeover bid occurs when a person, or persons acting in concert, acquire either through a single purchase or through a series of purchases of a target's shares, "control" of the target company. Corporate control is manifested through various degrees of share ownership and/or influence over a company. What will constitute effective control over a target is to a large extent, dependent on a number of factors unique to that particular company. What is clear however, is that effective control of a company can be

¹² C. R. Sector, "Takeovers And The Duties Of The Board of Directors: Comparative Aspects Of American And Canadian Standards" (1989-90) 20 R. de D. 131 at 133.

¹³ L. Rabinowitz, ed., Weinberg and Blank On Take-Over And Mergers, 5th ed. (London: Sweet & Maxwell, 1989) at 1001.

attained with far less than 51% of the company's shares.¹⁴ To illustrate the point, take for example the Canada Business Corporations Act ("C.B.C.A.") and the Business Corporations Act, 1982 (Ontario), ("O.B.C.A."). Both acts have designated that for the purpose of defining a takeover bid, the percentage of control, be it direct or indirect, of the target company's shares, is set at 10%.¹⁵ Meanwhile the Securities Act (Ontario) and the British Columbia Securities Act, continue to maintain that effective control of a company occurs when 20% or more of that company's outstanding voting or equity shares have been acquired or are controlled by a person or persons acting in concert. Once control is deemed to have been obtained, takeover bid rules and regulations are automatically triggered.¹⁶

Prior to launching an unsolicited takeover bid it is most

¹⁴ T. Hadden, R. Forbes & R. Simmonds, Canadian Business Organizations Law, (Toronto: Butterworths, 1984) at 509-512. F. Iacobucci, M. L. Pilkington & J. R. S. Prichard, Canadian Business Corporations An Analysis Of Recent Legislative Developments, (Agincourt Ontario: Canada Law Book Ltd, 1977) at 462-463.

¹⁵ R.S.C. 1985, c. C-44 at s. 194; S.O. 1982. c. 4 as amended at s. 186(2), respectfully.

¹⁶ S.O., 1987, c.7 at s. 88(1); S.B.C. 1985, c. 83 as amended at s. 74(1), respectfully. See also 13 Ontario Securities Bulletin at 2298, "Request for Comments" 3 June, 1990, where the Canadian Securities Administrators proposed that the present 20% level for the purposes of defining a takeover be reduced to 10%. See also Gillen's views to the proposed changes, and in respect to the rules and regulations governing the securities market place generally, supra, note 1. But also see Dey, supra, note 6.

likely that the offeror conducted an exhaustive research into the background of the target, gathering and analyzing as much information as is practical in respect to such matters, for example; the target's financial position, the demographics of its shareholders, whether it has any anti-takeover defensive mechanisms in place, and if so, how best to circumvent them, etc. All this is done in order to determine how to frame the takeover bid so as to solicit the maximum positive response possible from the target shareholders.¹⁷

Although compelled to comply with the rules and regulation set out for making an unsolicited takeover bid in Canada, the goal of the offeror is to seize in as short of time as is legally possible, that requisite number of shares in the target company necessary to garner control. To this end the offeror relies upon secrecy and speed in launching the bid. Secrecy is important so that the target company's board of directors is not forewarned that a takeover bid is imminent. This denies the target directors an opportunity to plan defensive response tactics specifically designed to thwart the offeror's bid. Also the offeror does not want the news of its upcoming takeover bid to be made public prematurely because that would only cause the price of the target shares to increase. Generally, the price of a company's shares will increase if it is anticipated that a

¹⁷ See Iacobucci, supra, note 7 at 137ff.

takeover bid for that company will be made. Shares of H. J. Heinz Company rose US\$2.12 in the first few hours of trading "after rumors that the food and condiment maker could be the target of a takeover attempt". Conversely, rumours that a bid will be blocked or withdrawn will typically result in the decrease in value of a target company's shares. Once the official announcement of a takeover bid is made, the trading volume and price of the target's shares will rise dramatically, reflecting investors' and arbitrageurs' perceptions that a premium will be paid on the shares should the takeover bid, or a competing bid succeed.¹⁸

In anticipation of launching a successful bid, an offeror should always be prepared for the eventuality that the initial planned costs of the bid may have to be substantially augmented should the target company's board of directors employ defensive tactics and/or competing offers for the target are made. Although rarely invoked in the past, an offeror should also be cognizant of the fact that a planned

17(a) Ass. Press, "Takeover rumour heats Heinz" The Globe & Mail (21 Aug. 1991) B 3.

17(b) D. Westell, "Campbell Soup shares fall" The Globe & Mail (22 June 1991) B 2.

¹⁸ See R. Sappdeem, "Motivation Of Offeror Company Directors In Corporate Acquisitions" (1987) 9 U. Pa. J. Int. Bus. L. 67 at 95- 98. See also B. E. Eckbo, "Mergers and the market for corporate control: the Canadian evidence" (1986) 19 Can. J. of Econ. 236; A. Robinson, "Arbitragers get panicky" The Globe & Mail (16 May 1992) B 1.

takeover (merger) may be deemed to contravene the federal government's Competition Act, (S. C....) as preventing or significantly lessening competition in the market place. As a consequence of the Act, Imperial Oil Ltd. was denied the right to complete its proposed \$5 billion takeover of Texaco Canada Inc. unless it agreed to a number of pre-conditions required by the federal Bureau of Competition Policy aimed at ensuring continuous and vigorous competition amongst the independent gasoline retailers in the Atlantic provinces. So too, Southam Inc. came under the scrutiny of the Bureau of Competition with its purchase of control of two local B.C. newspapers back in early 1990. The Bureau was of the opinion that Southam's acquisition would unduly lessen the competition in respect to the newspaper advertisement business in the B.C.. The Competition Tribunal (the final arbitrator of these matters under the Act) decided early this past June, that because of the community based nature of the Vancouver Courier and the North Shore News (the two papers acquired by Southam) there was no undue lessening of competition, for the reason that the advertisers who use community based newspapers do not compete with advertisers who are likely to use the larger daily papers in Vancouver. ¹⁹

¹⁹ See re: A Freeman Imperial Oil "Tribunal still not satisfied on takeover" The Globe & Mail (27 Jan. 1990). See re: Southam J. Partridge "Southam's B.C. takeover still on hold" The Globe & Mail (19 Sept. 1990) B 5; D. Fagan "Southam beats back anti-competition challenge" The Globe & Mail (3 June 1992) B 3. Interestingly there is a provision under the Act allowing for a three year "monitoring period" within which

It may be expected that an offeror was actively engaged in a surreptitious acquisition programme ("creeping acquisitions") of shares in the target company prior to the official public disclosure that a takeover bid would be made. The acquisition of target shares under this practise will be kept to a point somewhere below that percentage of share ownership which would automatically trigger the takeover bid rules, or that would likely tip off the target company's board of directors of the impending bid. It may be possible to acquire control of a company without ever having triggered the applicable governing takeover bid provisions. It is said of the Toronto based Edper Bronfman conglomerate, that by captializing on those "grey and fuzzy areas in Canadian tax, corporate and securities laws" and through slow and steady stock purchases on the open market and by private agreement, that company has "made the creeping takeover into something of a fine art." ²⁰

Buying up shares in a target before making its takeover bid also allows the offeror to establish a "toehold" in the company. Furthermore, acquisitions of target shares purchased at the "pre-takeover bid" price can also be advantageous to

time the Competition Tribunal could disallow a takeover or merger as having breached the Act's mandate.

²⁰ K. Noble, "Merchant bankers test their limits" The Globe & Mail (13 Apr. 1991) B 18; " A Hees deal leaves its mark" The Globe & mail ((Feb. 1991) B 1-B 2, B 18 respectfully; see also Borrelli, supra, notes 1 at 906.

the offeror of a takeover bid should it be determined that a competing bid for the target is likely to succeed. In this situation the offeror's "pre-takeover bid" shares can be tendered to its competitor at the higher "post-takeover bid" price, thus enabling the offeror to recoup some of the expense it incurred in making its failed bid. ²¹

An unsolicited takeover bid is usually an orchestrated attempt by the offeror to circumvent, (at least in the initial stages of its campaign for control) any necessary involvement with, or approval from, the target company's board of directors. ²²

Unsolicited takeover bids are frequently referred to as "hostile takeovers". The term "hostile", in reference to the relationship between the offeror and the shareholders of the target company is really a misnomer. If anything target shareholders look upon an unsolicited takeover bid for their shares with favour. ²³ Any hostility that may develop as a consequence of an unsolicited takeover bid being made is more aptly seen as a reflection of the often derisive relationship that can exist between the boards of directors of the

²¹ See the comments of Gillen, supra, note 1 at 139-40.

²² Iacobucci, supra, note 7 at 133.

²³ This will be discussed in more detail below.

participating companies.²⁴

The affects on the target company once a takeover bid is announced can be quite drastic. Expectedly, the target company's board of directors will be engrossed in determining how best to respond to the offer, while all other management considerations will likely become secondary in importance. Employees of the target company will also have concerns over their own prospects should the company be taken over. Often opportunistic head-hunters or competitors of the target company will try to capitalize on the this mood of uncertainty, endeavouring to solícite away the target's top employees. It has been said that once a company becomes a target of an unsolicited takeover bid it develops a "siege-like mentality".²⁵

Why it may be asked, does one company seek to gain control over another? The primary reason is that the offeror anticipates that some positive benefit will be incurred, usually in the form of enhanced profits. Although there are numerous reasons, the following are some examples of why one company would seek to control another: 1) The offeror may feel

²⁴ Iacobucci, supra note 7 at 133. See R. C. Brown, "The Role of the Courts in Hostile Takeovers" (1988/89) 93 Dick. L. Rev. 195 at 197.

²⁵ Pitt, supra, note 4 at 839-842. Iacobucci, supra, note 7 at 134-35.

that the poor management practices of the target has resulted in the company operating at below full capacity. By gaining control of the target company and installing its own management team, the offeror hopes to rectify these deficiencies and benefit from the target's new efficiency. 2) The offeror may perceive that the market price of the target shares are extremely depressed and not reflective of the company's true worth. If control can be achieved at, or near, the present trading value of the target's shares, a bargain acquisition can be made. 3) Possibly the target's modes of production or its market share for its products or services would complement or supplement those of the offeror, or the offeror's plans for future expansion. 4) Control of the target company may eliminate the threat of it becoming a significant competitor of the offeror. 5) The target may have a subsidiary, or segment of its own operations that is particularly desirable to the offeror, 6) The target company may be highly liquid, enabling the offeror to sell off the target 'piecemeal' at a profit over the acquisition costs. 7) Tax ramification for the offeror may play an important reason in why a target was sought out. 8) The target may be acquired simply to reinforce or satisfy subjective desires for power or prestige of certain members of the offeror's executive management team.²⁶

²⁶ See generally, J. G. Christy, "Corporate Mismanagement As Malpractice: A Critical Reanalysis Of Corporate Managers' Duties Of Care And Loyalty" (1984) 21 Houston L. Rev. 105 at

The use of the unsolicited takeover bid as a means to acquire corporate control has become, and is likely to remain, a permanent fixture within the business community. While its prevalence may be an acknowledged fact, its utility in promoting the interests of shareholders specifically, and its effect on the economy and our society remains disputed. Is the takeover bid situation so unique as to require special considerations and placement of safeguards when it comes to the involvement of the target company's board of directors. Are the benefits that may be incurred by permitting target directors to become involved in the takeover bid process outweighed by the potential risks such involvement might carry? When a takeover bid is announced, should the board of directors of the target company be banned completely from interfering in anyway with the bid or, should their activities merely be restricted in some fashion? If so, how so? ²⁷

This issue, unlike any other in the area of corporate control management, is extremely divisive there are a wide range of theories proffered with respect to what extent target directors should be permitted to respond to an unsolicited takeover bid running the gambit from total abstinence to

112; Brown, supra, note 24 at 198-99; Tarasofsky, supra, note 8 at 10; Rabinowitz, supra, note 13. Iacobucci, supra, note 7 at 137-38.

²⁷ Stephanie Rees, "Directors' Unfair Conduct as a Ground for Remedy under the Companies Act (1985-86) Co. & Sec. L. J. 63 at 65-66.

unbridled involvement.²⁸ These issues are very involved and unfortunately, for the purposes of this paper, can only, in the briefest of ways, be addressed below.

At the heart of this dichotomy is a perception of the efficacy of a target company's board of directors responding to an unsolicited takeover bid for the purpose of promoting the interests of the company and its shareholders. In a broader sense it may be asked whether takeover bids in general play any positive role in advancing the betterment of the economy or the welfare of our society. Unfortunately the empirical data proffered by both the promoters and the detractors on these issues is at the very best, indecisive.

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On the "pro" side, it is argued that corporate takeovers can have a salutary affect both on the interests of the shareholders and on the welfare of the economy and society. The salient features of these benefits are that the threat that an unsolicited takeover bid could be made acts upon a

²⁸ See generally Brown, supra, note 24 at 199-203; Borelli, supra note 1 at 892-3; Farrar, supra, note 1 at 17ff; Howard, supra, note 7 at 57-63; Iacobucci, supra, note 7 at 133-36.

²⁹ Farrar, supra, note 1 at 40. See generally Eckbo, supra, note 18; Tarasofsky, supra, note 8; Howard, supra note 7; Adams, supra, note 5; Sappdeem, supra, note 18; A. Freeman, "Takeovers no sure cure" The Globe & Mail (13 June 1991) B 13.

company's board of directors as a catalyst to ensure that their corporation performs at its optimum level. This increases corporate efficiency which correspondingly advances the interests of shareholders. Company's with poor business records will become subject to takeover bids by others who perceive that they can utilize the assets of the target more efficiently, hence more profitably. In turn, this means that not only are poor management practices weeded out, but also that the nation's resources are put to their maximum use.³⁰

It is reasonable to speculate that, (as in any arms length business transaction) in the context of an unsolicited takeover bid, the offeror will try to purchase the target shares at the lowest price possible.³¹ As such, it has been argued that the participation of a target company's board of directors in responding to an unsolicited takeover bid is good for the target shareholders who, as a diverse group, are in an inferior bargaining position to the offeror. The board of directors of the target company on the other hand, can effectively represent all the company's shareholders and negotiate with the offeror on a more equitable basis. Further, it is maintained that the target directors, because

³⁰ See F. H. Easterbrook & D. R. Fischel, "The Proper Role Of A Target's Management In Responding To A Tender Offer" (1981) 94 Harv. L. Rev. 1161 particular at 1182ff; Gillen, supra, note 1. See generally Howard, supra, note 7 at 55-63 & 74-77.

³¹ Pitt, supra, note 4 at 834.

of their intimate knowledge of the company; will know whether the true and intrinsic value of the company is properly reflected in the bid. Where it is not, the target directors can implement defensive tactics and/or solicit competing bids in order to secure for the shareholders a better deal. ³²

Alternatively, those on the "con side" maintain that the use of unsolicited takeover bids to obtain corporate control has had a chilling affect on the welfare of our society and on our economy as a whole, by increasing market instability and generating vast exchanges of corporate equity for debt, while at the same time causing massive disruptions and unemployment for the country's work force. 33(a)

A primary concern for those who advocate that target directors refrain from intervening in takeover bids, is that if a takeover bid were to succeed, the threat posed to the incumbent directors is painfully apparent - the target directors may very well be removed from office. On this basis it is argued that target directors may be tempted to pervert the wide range of their powers to manage the business and affairs of the company by implementing defensive tactics under the guise of serving the best interests of the company, but

³² Dey, supra, note 6 at 256; G. Coleman, "Poison Pills In Canada" (1989) 15 Can. Bus. L. J. 1 at 4; L. Herzel, J. R. Schmidt & S. J. Davis, "Why Corporate Directors Have a Right to Resist Tender Offers" (1980) 3 The Corp. L. Rev. 107 particularly at 111.

which are in fact for the purpose of perpetuating themselves in office. ³³

It has been argued that in the context of an unsolicited takeover bid, the interests of the shareholders are better served by requiring the directors of the target company to refrain from implementing defensive manoeuvres and instead, limiting their role to such things as disseminating information to their shareholders with respect to the adequacy of the takeover bid. ³⁴

Even if one accepted that the involvement of target directors in the takeover bid scenario results in increases of the premiums paid to the target company's shareholders, Professors Frank Easterbrook and Daniel Fischel argue that such activity is counter-productive to the overall welfare of shareholders in the market place. This is because the costs for conducting a successful takeover bid would necessarily increase, which correspondingly would decrease the frequency in which takeover bids are made. A diminution of the number

33(a) See Borrelli, supra, note 1 at 892-93.

³³ See J. G. MacIntosh, "The Poison Pill"; A Noxious Nostrum For Canadian Shareholders" (1989) 15 Can. Bus. L. J. 276 at 281; Howard, supra note 7 at 58; Easterbrook & Fischel, supra, note 30 at 1175; Michael St. Patrick Baxter, "The Fiduciary Obligations Of Directors Of A Target Company In Resisting An Unsolicited Takeover Bid" (1988) 20 Ottawa L. Rev. 63 at 74.

³⁴ Iacobucci, supra, note 7 at 165-166.

of takeovers is detrimental, say Professors Easterbrook and Fischel, because the existence of a general threat of a possible takeover bid acts as an effective and cost efficient way in which to monitor poor management performance in the public sector. ³⁵ Along these same lines, it has been advanced that there is a zero sum again for the shareholders of the companies involved in a contested takeover bid that results in an increase in the premiums paid, because what is a gain for the one side is a corresponding loss to the other. ³⁶

It can also be seen that in today's business environment, at least in respect to widely held public companies, the centralization and concentration of power within the board of directors has led to a marked decrease in what has been termed "shareholder democracy". With the rise in the number of shareholders in a company there can result a corresponding decrease in the ability of the shareholders to instill in their board of directors a sense of accountability. The sheer number and diversity of shareholders can create an inability for shareholders to collectively utilize the voting power

³⁵ Supra, note 31 particularly at 1169, 1178-79. See generally, MacIntosh, "The Poison Pill; A Noxious Nostrum", supra, note 33, particularly at 315-16; But see J. G. MacIntosh, "The Shareholders' Appraisal Right in Canada: A Critical Reappraisal" (1988) 13 Can-U.S. L. J. 299 at 322-27.

³⁶ See Sappdeem, supra, note 18 at 104; MacIntosh, "The Poison Pill; A Noxious Nostrum", supra, note 33 at 315.

attached to their shares to effectively determine who will be elected to the board of directors. Shareholders of large companies often are not interested in and therefore do not attend to intra-corporate matters such as the election of the board of directors. Those who do, usually vote in favour of the recommended slate of directors set out in the proxy solicitation which is controlled by the board of directors in the first place. Professor Berle addressed these concerns in his celebrated article, "Corporate Powers As Powers In Trust". Professor Berle advocates that the powers afforded directors in the management of their companies are powers held in trust, exercisable for the sole benefit of the company's shareholders. The "trust" aspect of Professor Berle's theory reflects his concerns for the need to control the potential for abuse by directors of their powers - in short, directors need to be held more accountable to the shareholders for their conduct. ³⁷ As such, it has been argued that the final decision of whether a takeover bid will succeed or not should remain solely with purview of the target shareholders as a vital check in controlling directors' powers and giving some semblance to the concept of directors' accountability. ³⁸

³⁷ See A. A. Berle, "Corporate Powers As Powers In Trust" (1930-31) 44 Harv. L. Rev. 1049. See also E. M. Dodd, "For Whom Are Corporate Managers Trustees?" (1931-32), 45 Harv. L. Rev. 1145 at 1147; Easterbrook & Fischel, supra, note 30 at 1171, 1192.

³⁸ Tarasofsky, supra, note 8 at 2.

Despite the potential that target directors may be motivated to respond to an unsolicited takeover bid out of self-interests, the general consensus, at least of those who are responsible for overseeing securities activity in Canada, is that such intervention can have a benefit in promoting the interests of shareholders, and of our economy.³⁹ The larger and more pressing question it is proposed, is to what extent can a board of directors go in defending their company from an unsolicited takeover bid which they perceive not to be in the best interests of their company, and why?

³⁹ National Policy No. 38, Take-Over Bids - Defensive Tactics at particularly para. 1 and 6. See V. P. Alboini, Securities Law and Practice (Toronto: Carswell, 1984) Vol. 4 at 27-109. National Policy No. 38 follows and mirrors an earlier policy statement guideline (9.4) of the Ontario Securities Commission. Note, at present there is no federal agency responsible for the management of the securities industry in Canada, rather it is regulated at the provincial level.

CHAPTER TWO

THE MANAGEMENT OF THE BUSINESS AND
AFFAIRS OF A COMPANY

As previously discussed, a typical unsolicited takeover bid will be made directly to the shareholders of the target company, negating the necessity of having to engage the consent of the target company's board of directors. Where an offer to purchase shares, or the solicitation to sell shares, is made directly to a shareholder the relationship created between the offeror and the shareholder is one of a private matter. Subject to any restrictions with respect to a shares transferability, shareholders are generally at liberty to sell their shares to whomever, and at whatever price they choose. Lord Greene M.R., once pointed out, in the case of Smith v. Fawcett that, "...it is to be borne in mind that one of the normal rights of a shareholder is the right to deal freely with his property and to transfer it to whomsoever he pleases." ⁴⁰ Lord Wilberforce stated in Howard Smith Ltd. v. Ampol Petroleum Ltd. that, "[t]he right to dispose of shares at a given price is essentially an individual right to be exercised as an individual decision..." ⁴¹

⁴⁰ [1942] Ch. 304, at 306.

⁴¹ [1974] A.C. 821, [1974] 1 All E. R. 1126 (P.C.) at 1 All E. R. 1135-36.

Although abstinence is one view exposed as to the appropriate role of the target company's board of directors in the context of an unsolicited takeover bid, the law states, as is set forth under the applicable provincial or federal corporate statute, that it is the board of directors, acting in their collective capacity who are responsible for managing, or supervising the management of, the business and affairs of the company. Professor Welling stated that, "[i]n the modernized Canadian corporate jurisdictions the board of directors are collectively given a statutory power to run the business of the corporation."⁴² This statutory requirement (which essentially is a codification of the applicable common law⁴³) is aptly illustrated by sections 102(1) & 122(1) of the C.B.C.A.:

s.102(1) Subject to any unanimous shareholder agreement, the directors shall manage the business and affairs of a corporation.⁴⁴

⁴² B. L. Welling, Corporate Law In Canada The Governing Principles 2d. ed. (Vancouver: Butterworths, 1991) at 317. See J. L. Howard, "Fiduciary Relations In Corporate Law" (1991) 19 Can. Bus. L. J. 1 at 9.

⁴³ J. Stransman & A. A. Greenwood, "Appropriate Actions for Directors" (August, 1988) vol. 5 No. 8 Mergers & Acquisitions, 61 at 62.

⁴⁴ E.g. provincial legislation, O.B.C.A. s.115(1); British Columbia Company Act, R.S.B.C. 1979, c.59, as am. "B.C.C.A." s.141(1).

An unanimous shareholder agreement is, "[a]n otherwise lawful written agreement among all the shareholders of a corporation,

s. 122(1) Every director and officer of a corporation in exercising his powers and discharging his duties shall

(a) act honestly and in good faith with a view to the best interests of the corporation; and

(b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. ⁴⁵

Whether in actual fact, business strategies are more likely to be determined by a company's higher echelon of senior management employees rather than the board of directors, is another matter. Professor Welling is of the opinion (an opinion widely shared by others) that in today's

or among all the shareholders and a person who is not a shareholder, that restrict, in whole or in part, the powers of the directors to manage the business and affairs of the corporation..." See C.B.C.A. s.146(2), O.B.C.A. ss.115(1) & 108(2), B.C.C.A. ss. 141(1)(2) & 243.

⁴⁵ See O.B.C.A. s. 134(1)(2); B.C.C.A. s. 142(1)(a)(b)(i)(ii). Note: In the B.C.C.A. there is no reference that directors are to act with a "view to the best interests of the corporation".

The statutory duty of care of a director or officer, has codified and substantially augmented what was demanded at common law. See for example, Neville J.'s comments, in Re Brazilian Rubber Plantation v. East States Limited, [1911] 1 Ch. 425 (C.A.) at 437. The test now is objective and the requirements are that the directors & officers exercise the care, diligence and skill that a reasonable prudent person would exercise. In relation to the skill demanded of target directors in responding to a takeover bid see Iacobucci, supra, note 7 at 162-3. But see generally Christy, supra, note 26; L. C. B. Gower, Modern Company Law 4th ed. (London: Stevens & Sons, 1979) at 603, & note 22.

business realities the former rather than the latter is more likely the case. It has been suggested that "...the boards of directors of most large and medium-sized companies do not establish objectives, strategies and policies, however defined. These roles are performed by company managements." ⁴⁶ Professor Welling lauds the decision of the Supreme Court of Canada in Canadian Aero Service Ltd. v. O'Malley ⁴⁷ as a breakthrough in judicial recognition of the actual role the executive management branch of a company plays in developing corporate policies and business strategies. ⁴⁸ In either case, both directors and officers are charged similarly in the performance of their duties and obligations attached to their office.

It is in the execution of their duties and obligations that the law has attempted to circumvent any exculpatory provisions that a director or officer may seek to rely upon in an effort to avoid statutory liability. Generally stated, directors and officer are liable for any breach of the Act or

⁴⁶ Welling, supra, note 42 at 299 and footnote 6 at 299, referring to M. L. Mace's article, Directors - Myth and Reality.

⁴⁷ [1974] S.C.R. 592, (1973), 40 D.L.R. (3rd) 371.

⁴⁸ Welling, supra, note 42 at 325 & note 93. But see (Dec. 1983), Continuing Legal Education, Law Society of Upper Canada, Shareholders and Directors Rights, Responsibilities and Obligations, (Osgoode Hall, Toronto, 1983); J. Conger, "Impotent directors last to shout fire" The Globe & Mail (9 July 1990) Book review of J. Conger, Pawns or Potentates (Toronto: McGraw-Hill Ryerson).

its regulations, and they cannot contract out of such liability or seek exclusion from liability through provisions made to the company's articles, by-laws or resolutions.⁴⁹ However, there are generally provisions in the corporate statutes in Canada that recognize that where directors honestly rely on reports prepared by persons "whose profession lends credibility to statements made by them in the report", for example the company's auditors, lawyers, accountants, engineers, etc., directors will not be held liable for a breach of his or her duties should the information contained in the reports be incorrect.⁵⁰

Where a professional report only "flags" a potential problem that may affect the interests of a company, or where the results of a report are themselves open to interpretation, it is another matter entirely as to what extent, beyond making the contents of the report known, that the authors of the report must go in advising the directors. Or conversely, to what extent the board of directors should go in satisfying themselves whether or not to act on the information contained in the report. If a company incurs losses that might otherwise have been avoided had the information disclosed in

⁴⁹ See C.B.C.A. s. 122(3); O.B.C.A. s. 134(2)(3); B.C.C.A. s. 143.

⁵⁰ See C.B.C.A. s. 123(4); O.B.C.A. s. 135(4); or B.C.C.A.'s arguably less encompassing provision, s. 151(9)(a)(b).

a report been acted upon differently, is it the fault of the directors for failing to grasp the seriousness of the problem, or are the authors of the report to blame for not advising their clients properly? The point is well illustrated in the recent Standard Trusco Ltd. affair, where the Ontario Securities Commission accused Standard Trusco's directors of releasing a misleading press release with respect to the company's fiscal integrity prior to its collapse. The directors of Standard Trustco countered that the responsibility for the debacle lay with their auditors who they alledged were negligent in their business practices and had failed to impress upon the board the seriousness of their company's financial position. Placer Dome executives also recently admitted that their company had incurred heavy losses in their acquisition of Mount Miligan because they had relied too heavily on inadequate geological analysis. 51(a)

The inclusion of the words, "with a view" in the statutory requirement that directors endeavour in the execution of their duties to promote "the best interests of the company", suggests a legislative initiative to broaden the range of potential factors directors may properly consider as relating to a company's interests. To illustrate this point by contrast, take for example, the case of Parke v. Daily News Ltd., where the directors of a company which had substantially sold off its business interests, tried to give the redundant

employees the proceeds from the sale as a gesture of good faith. The court held that regardless of how meritorious the directors motives were, such conduct did nothing to **directly** promote the interests of the company, nor could it be shown to be, "reasonably incidental to the carrying on of the company's business." ⁵¹

In the American case of Dodge v. Ford Motor Co., Henry Ford, founder and president of the Ford Motor Company, was enjoined from carrying out his plan to share some of his company's enormous profits with members of the general public by reducing the sale price of his cars by eighty dollars. Ostrander, C. J. stated that despite Mr. Ford's philanthropic and altruistic sentiments, "[a] business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. ...it is not within the lawful powers of a board of directors to shape and conduct the affairs of a corporation

50(a) See re: Standard Trustco K. Howlett, "Standard directors breached securities laws, OSC alleges" The Globe & Mail (17 April 1992) B 1; A. Robinson, "OSC says Standard ignored warning signals" The Globe & Mail (2 June 1992) B 10; A Robinson "OSC hears tale of turf battle" The Globe & Mail (4 June 1992) B 9; K. Howlett & M. Wood, "Standard directors sue Peat Marwick: Auditors accused of negligence" The Globe & Mail (5 June 1992) B 1, B 10; A. Robinson, "Palcer Dome shakes its " (8 May 1992) C 1.

⁵¹ [1962] Ch. D. 927 at 928.

for the merely incidental benefit of shareholders and for the primary purpose of benefiting others..."⁵²

It is still the case today that directors cannot carry on the business and affairs of the company totally oblivious to the legitimate concerns and interests of the shareholders. However, it is generally acknowledged that directors may consider any number of factors that do not necessarily or directly result in some immediate or tangible benefit for the company, so long as there is some reasonable nexus to the interests of the company as a going concern.⁵³ Despite this increase of judicial and societal acceptance that directors should be permitted to consider interests outside those directly connected to the company and its shareholders, the "established case law holds to that directors' conduct must related back to wealth maximization for the company."⁵⁴ Today's company directors may do well to pay heed to the words of Bowen L. J., in Hutton v. West Cork R.R. Co., who advised that:

⁵² (1919) 204 Mich. 459, 170 N.W. 668 at 684.

⁵³ Although s. 142(2)(a) of the B.C.C.A. may lack the direct inclusion of the words that the directors may act "with a view to the best interests of the company", one would be hard pressed to say that as a consequence of this omission the role of B.C. directors is statutorially more restrictive. See Berger J.'s comments in Teck Corporation Ltd. V. Millar [1973] 2 W.W.R. 385, 33 D.L.R. (3d) 288 (B.C.S.C.) "Teck" at W.W.R. 412-13, at D.L.R. 314.

⁵⁴ Iacobucci, Canadian Business Corporations, supra, note 14 at 295.

Most businesses require liberal dealings. The test there again is not whether it is bona fide, but whether, as well as being bona fide, it is done within the ordinary scope of the company's business, and whether it is reasonably incidental to the carrying on of the company's business for the company's benefit.... The law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company.⁵⁵

The comments once made by Professor Dodd seem to aptly describe the relative balance that has so far made this an issue more for academics than for the courts. Professor Dodd stated that:

Judicial willingness - which has increased of late - to allow corporate directors a wide range of discretion as to what policies will best promote the interests of the stockholders, together with managerial disinclination to indulge a sense of social responsibility to a point where it is likely to injure the stockholders, has thus far prevented the issue from being frequently raised in clear-cut fashion in litigation.⁵⁶

The term "directors" generally denotes those individuals

⁵⁵ (1883), 23 Ch. D. 654 (C.A.) at 672-73. See generally Iacobucci, supra, note 7, at 163; L. Getz, "Discretion of Corporate Management To Do Good at the Expense of Shareholders' Gain - Canadian Corporate Law" (1987-88) 13 Can.- U.S. L. J. 1; L. C. B. Gower, "Corporate Control: The Battle For The Berkeley" (1955), 68 Harv. L. Rev. 1176 at 1191-93; A. A. Sommer, "Whom Should The Corporation Serve? The Berle-Dodd Debate Revisited Sixty Years Later" (1991), 16 Del. J. of Corp. L. 33; A. A. Berle, supra, note 37; Dodd, supra, note 37 at 1153ff; Easterbrook & Fischel, supra, note 30 at 1191-92. See also infra, notes 300-03 and accompanying text.

⁵⁶ Dodd, supra, note, 37 at 1157.

who have been formally elected or appointed to a company's board of directors. Where however, a person possesses in substance de facto powers of a director through his or her ability to influence or direct company policy, for example, in how a company might respond to an unsolicited takeover bid, then regardless of the absence of an official title, the individual can be deemed under the prevailing corporate statute to be a director. The intent of such a provision is to ensure that those who have the power to affect the management of the business or affairs of a company will be held accountable for the proper exercise of such powers.⁵⁷

Although now prescribed by statute, Anglo-Canadian jurisprudence has traditionally maintained that it is the responsibility of the directors and not the shareholders, to run the company. The courts have ardently and consistently articulated a general policy of judicial non-intervention when it comes to questions relating to internal management policies of a company.⁵⁸ Such judicial deference can be traced as

⁵⁷ See C.B.C.A., s. 2(1), which states that a "director" means a person occupying the position of director by whatever named called...".See also O.B.C.A., at s. 1(16), and B.C.C.A., s. 1.

⁵⁸ See Iacobucci, supra, note 7 at p. 162. B. Cheffins, "The Oppression Remedy In Corporate Law: The Canadian Experience" (1988), 10 U. Pa. J. Int'l Bus. L. 305 at 307. In the United States, judicial deference to director's management decisions found expression in the legal doctrine known as the, Business Judgment Rule, see J. L. Howard, "Fiduciary Obligations Directors And Officers" in Fiduciary Obligations, Materials prepared for a Continuing Legal

far back to at least 1797, with the case of Charitable Corporation v. Sutton.⁵⁹

Underpinning the courts' reluctance to become involved in the management decisions of directors, may in part be based on what was then a prevalence within the judiciary of majoritarianism.⁶⁰ Majoritarianism is the notion that the directors would represent the interests of the majority of the shareholders who had elected them to office, and it was the interests of the majority that was to be considered paramount in forging company policy.

Generally this judicial restraint was premised on a variety of beliefs. In part the courts maintained that they lacked the jurisdiction to intervene into the internal affairs

Education seminar (Vancouver: The Continuing Legal Education Society of British Columbia, April, 1989) at 3.1.18.

⁵⁹ 26 E.R. 642, *per Spector*, *supra*, note 11 at 143. See however Fraser v. Whalley (1864) 71 E.R. 361 at 369, where the court found that the directors had breached their fiduciary duties by attempting to issue shares on the basis of an obsolete shareholders' resolution. What is interesting in this decision was that the court's determined that what is in the interest of the company was best left to be decided by the shareholders. Vice-Chancellor Sir W. Page Wood stated, "I say nothing on the question whether the policy advocated by the directors, ... is the more for the interest of the company. That is a matter wholly for the shareholders."

⁶⁰ J. G. MacIntosh, "Minority Shareholder Rights In Canada And England: 1860-1987" (1989), 27 Osgoode Hall L. J. 561 at particularly 597-605. See also P. Anisman, "Majority - Minority Relations in Canadian Corporate Law: An Overview" (1987-88), 12-13 Can - U.S. L. J. 85 at ⁶⁰ 86, 92.

of the company and that the directors, not the courts, possessed the business acumen and intimate knowledge of the particular needs of the company to determine what was in its best interests. ⁶¹ Professor R. W. Parsons stated once, in respect to directors' duty of care that:

Judges, we are told, are equipped to assess good faith but generally they lack the commercial experience on which to found the fine distinctions which would be called for if the law imposed something more than a relaxed standard of care. Reassuring observation is offered to the effect that so long as the law ensures that directors' hearts are pure, it may not matter that some directors are incompetent. ⁶²

Additionally, it was also felt that it would be unethical and counterproductive in persuading qualified individuals to come forth to act as directors if the courts were, with the benefit of hindsight, to second guess the decisions made in good faith by the directors. ⁶³ To this end, actions brought impugning the management decisions of a board of directors typically received curt dispatch by the judiciary.

The following three cases of, Automatic Self-Cleansing

⁶¹ See Welling, supra, note 42 at 346-47 & note 148.

⁶² "The Director's Duty of Good Faith" (1966), 5 Melb. U. L. Rev. 395, cited in J. B. Harper, and A. A. Browne, "The Duties and Liabilities of a Director in 1973" (1973), 47 Aust. L. J. 447 at 447-48.

⁶³ See Farrar, supra, note 1 at 19; Spector, supra, note 11 at 135-37.

Filter Syndicate Co. Ltd. v. Cuninghame ⁶⁴, Re Smith v. Fawcett Ltd. ⁶⁵, and Harlowe's Nominees Pty. Ltd. v. Woodside (Lakes Entrance) Oil Co. N. L. ⁶⁶, will suffice to briefly illustrate the point of the continual judicial reaffirmation of the import of the board of directors' role in managing the business and affairs of a company.

In Automatic Self-Cleansing Filter Syndicate Co. Ltd. v. Cuningham, one dominant shareholder, in his determination to have the assets and undertaking of the company sold off, orchestrated the passing of a shareholder's resolution, (with a bare majority) to affect the sale. The directors refused to act on the resolution out of their convictions that the sale would not be in the best interests of the company. At trial and at appeal the courts declined to intervene to force the directors to adopt the said resolution. It was the opinion of the courts that the directors had been duly delegated the authority to manage the affairs of the company. It was therefore, up to the directors and not the shareholders to decide how best that authority would be executed. The only way for the shareholders to properly "challenge" the authority of the directors prior to the expiration of their slated

⁶⁴ [1906] 2 Ch. D. 34.

⁶⁵ Supra, note 40.

⁶⁶ (1969/70), 121 C.L.R. 483, (1968), 42 A.L.J.R. 123 (H.C. Aust.).

tenure in office, would be to remove them in accordance with the prescribed articles of the company. This required passing a special shareholders' resolution with a three-fourths majority, not merely a simple majority. Warrington J., at trial stated that:

It seems to me that if a majority of the shareholders can, on a matter which is vested in the directors, overrule the discretion of the directors, there might just as well be no provision at all in the articles as to the removal of the directors by special resolution. Moreover, pressed to its logical conclusion, the result would be that when a majority of the shareholders disagree with the policy of the directors, though they cannot remove the directors except by special resolution, they might carry on the whole of the business of the company as they please, and thus, though not able to remove the directors, overrule every act which the board might otherwise do.⁶⁷

In Smith v. Fawcett Ltd., the Court of Appeal refused to intervene on the behalf of an executor's petition to force a director of a company to register a testator's shares of the company, in the name of the executor. The director had offered to register only half of the shares, the other half he offered to purchase at a fixed price. The reason given by the director was that this arrangement would be in the best interests of the company. Lord Greene M.R. stated:

⁶⁷ Supra, note 64 at 38.

In the present case the principal director has sworn an affidavit which, if accepted, makes it clear that, whether rightly or wrongly, the directors have bona fide considered the interests of the company and come to the conclusion that it would be undesirable to register the transfer of the totality of these shares. ⁶⁸

[The directors] must exercise their discretion bona fide in what they consider - not what a court may consider - is in the interests of the company, and not for any collateral purpose. ⁶⁹

Harlowe's Nominees Pty Ltd. v. Woodside (Lakes Entrance) Oil Co. N. L. is a case where in essence, the plaintiff Harlowe, challenged the issuance of new shares in the company on the grounds that the company had no need for additional funds and that the only reason the shares were issued was to stop Harlowe from increasing its influence within the company through open market purchases of the company's shares. The Court of Appeal upheld the decision at trial that there was no rule at law that says shares may only be issued when there is a capital need. The directors could consider the future needs of the company as well, so long as the directors exercised their powers bona fide in the interests of the company. ⁷⁰

The High Court held that:

⁶⁸ Supra, note 40 at 309.

⁶⁹ Ibid. at 306.

⁷⁰ Supra, note 66 at C.L.R. 493.

Directors in whom are vested the right and duty of deciding where the company's interests lie and how they are to be served may be concerned with a wide range of practical considerations, and their judgment, if exercised in good faith and not for irrelevant purposes, is not open to review in the Court.⁷¹

Notwithstanding a traditional disinclination on the part of courts to become involved in questions relating to the internal management of a company, courts were and remain, very much inclined to intervene in the internal affairs of a company where there are substantiated allegations that the directors have been abusing their powers.⁷² Judicial intervention has been traditionally swift where the directors attempted to use their power over the allotting and issuing of shares in a company without initially offering such shares to existing shareholders on a proportionate basis to their original share holdings in the company.⁷³

⁷¹ Ibid. The question is what will the courts consider to be an irrelevant purpose? See Harper supra note 62 at 448.

⁷² Iacobucci, supra, note 7 at 163.

⁷³ See the comments of Buckley J. in Hogg v. Cramphorn, [1967] 1 Ch. 254, [1966] 3 All E.R. 420 at C.h. 270-71. But see Teck, supra, note 53 at D.L.R. 315, 328, at W.W.R. 413, 427-28. See generally Berle, supra, note 37 at 1056-60.

CHAPTER TWO - PART II

DIRECTORS AS FIDUCIARIES

That certain situations can evoke special obligations, obligations that we today describe as being fiduciary in nature, is a concept centuries old.⁷⁴ Over the years a number of various types of relationships have been recognized and categorized as typically emanating fiduciary-like qualities. Presently the field of fiduciary law is enjoying a "tremendous surge in academic interests".⁷⁵

What is important to note with respect to the establishment of fiduciary obligations is that, despite the fact that there are generally recognized and accepted categories of fiduciary relationships, whether a fiduciary duty exists or not is highly dependent on the particular circumstances of any given case. J. C. Shepherd remarked that, "[s]implistically put, the law of fiduciaries is about how the legal system decides which ...relationships...will be

⁷⁴ The basic concept behind today's modern theory of fiduciary law, "...can be traced in the civil law through the Code Napoleon of 1803, to the Institutes of Justinian enacted in the sixth century, and from there to the Twelve Tables of Rome of 450 B.C., ...", J. L. Howard, supra, note 58 at 3.1.01-02.

⁷⁵ Craig Orr, "The Changing Nature Of Fiduciary Obligations [sic]: Part I [1987] 1 Cnd. Corp. L. Reporter at C 1. See also D.W. M. Waters, "Lac Minerals Ltd. v. International Corona Resources Ltd." [1990] Can. Bar Rev. 454 at 456.

treated as fiduciary and enforced in law." ⁷⁶ (emphasies Shepherd's) Despite what the parties in a relationship perceive to be their legal obligations, where in substance the relationship is fiduciary in character, the law automatically deems the requisite duties, obligations and interests upon the participants involved. In essence then, fiduciary relationships are fact based determinative. ⁷⁷ Correspondingly, relationships that are typically considered fiduciary in nature may on further investigation, not be fiduciary after all. ⁷⁸ Laskin J. (as he was then) stated in Canadian Aero Service Ltd. v. O'Malley that, "[a]s in other cases in this developing branch of the law, the particular facts may determine the shape of the principle of decision without setting fixed limits to it." ⁷⁹

Three questions typically evolve around potential fiduciary relationships:

⁷⁶ Book review of Fiduciary Duties in Canada, by Mark Vincent Ellis (1990), 69 Can. Bar Rev. 398 at p. 399.

⁷⁷ J. L. Howard, supra, note 58 at 3.1.02, 3.1.08. In Farnham v. Fingold [1972] 3 O.R. 688 (Ont. H.C.J.) at 696, Morand, J. commented (after he had reviewed some of the leading cases on point) that whether or not a fiduciary duty was owing and to whom it was owed, is a matter of fact to be determined at by the courts.

⁷⁸ J. C. Shepherd, The Law Of Fiduciaries (Toronto: The Carswell Company Ltd., 1981) at 21. J. L. Howard, supra, note 58 at 3.08.

⁷⁹ Supra, note 47 at S.C.R. 619.

1. In the particular circumstances does a fiduciary relationship exist?
2. If yes, what is the scope of that duty?
3. Did the fiduciary act within the scope of his duty in circumstances where his interest or duty to a third person might be in conflict? ⁸⁰

Fiduciary relationships share certain common characteristics involving notions of trust and confidence. Specifically, fiduciary duties consist of loyalty, good faith, and avoidance of a conflict of duty, and self-interest. ⁸¹ Of all demands placed upon fiduciaries over the years, none is so strictly enforced by the courts than the duty of good faith. ⁸² Professor Berle once said that, [t]he moment, however, that "good faith" is introduced into the picture the fiduciary principle is raised." ⁸³ Fiduciaries must never place their own interests ahead of, or derive personal gain from, those whom they are to serve. Nor must a fiduciary let

⁸⁰ J. L. Howard, supra, note 58 at 3.1.04-05.

⁸¹ See Canadian Aero Service Limited v. O'Malley supra, note 47 at S.C.R. 610. J. L. Howard, ibid. at 3.1.04; P. S. Glennie, "Fiduciary Duty Doctrine Extended by Courts" (Apr. 1987) 4 Bus. & Law 25.

⁸² I. Feltham & W. R Rauenbusch, "Directors' And Officers' Liabilities In Canada" (1975-76) Can. Bus. L. J. 321 at 324.

⁸³ Supra, note 37 at 1054.

himself or herself be placed in a position that could compromise his or her obligations with a third party.⁸⁴

The role of a director in a company, barring any extraordinary circumstances, falls squarely within the construct of a fiduciary.⁸⁵ John L. Howard commented that, "for centuries there has been no doubt that corporate directors and officers are fiduciaries."⁸⁶ J. B. Harper and A. A. Brown once stated, "...the law has consistently treated a director as standing in a fiduciary relationship to his company. The courts may not have been consistent as to the precise fiduciary category to which a director belongs. But there is a unanimous view that he is a fiduciary of some kind."⁸⁷

It may be said that directors are fiduciary, not only because they act in an agency capacity,⁸⁸ but also because

⁸⁴ See the comments of La Forest J. in Lac Minerals Ltd. v. International Corona Resources Ltd., [1989] 2 S.C.R. 574, (1989) 61 D.L.R. (4th) 14., 69 O.R. (2d) 287; affg 62 O.R. (2d) 1, 44 D.L.R. (4th) 592; affg 53 O.R. (2d) 737, 25 D.L.R. (4th) 504 (H.C.J.), at S.C.R. 646-47.

⁸⁵ See Welling, supra, note 42 at 380-81. Other examples of fiduciary relationship would be, trustee-beneficiary, solicitor-client, partnership, see generally the decision of Sopinka J., in Lac Minerals Ltd., v. International Corona Resources Ltd., ibid. at 586-629.

⁸⁶ Supra, note 58 at 3.1.06.

⁸⁷ Supra, note 62 at 448.

⁸⁸ More will be said about directors as agents below.

the powers afforded directors to manage the business and affairs of the company are quintessentially fiduciary in nature. Craig Orr succinctly put it:

There is no doubt that a company director is a fiduciary vis-a-vis the company. There are cogent reasons for that. The director has tremendous power to affect the interests of the company, and the usual contract and tort remedies do not sufficiently protect the company's interests. The company is therefore vulnerable and at the mercy of the directors. This vulnerability is increased because the directors are entrusted with such extensive powers...The company has no direct control over how the directors exercise their discretion in these areas and that is why the law steps in and imposes on the directors a duty to exercise their power only in what they honestly consider to be [in] the interest of the company.⁸⁹

Professor Welling too has commented on this issue, stating that:

It has long been recognized that corporate directors owe fiduciary obligations to their corporations. Varying reasons for this have been advanced, but the most simple remains the most compelling: the board of directors, as the theoretical and sometimes practical "brain" of the corporate organism, exercises enormous power over corporate destiny. Each member of the board is a fiduciary.⁹⁰

It is because there exists within the purview of

⁸⁹ "The Changing Nature Of Fiduciary Obligations: Part II" (Jan. 1988) 1 Cnd. Corp. L. Reporter C 13 at C 15. See also J. L. Howard, "Fiduciary Relations In Corporate Law", supra, note 42 at 14.

⁹⁰ Supra, note 42 at 381.

director's authority to manage the company, such a wide range of powers, that there exists the potential threat of abuse at the hands of unscrupulous directors, or officers. Over the years the courts have intervened to enforce fiduciary standards on wayward directors, ensuring that the powers given to them are executed in the interests of the company only, and for no collateral or extraneous purpose.⁹¹

When a company is confronted with a takeover bid, the law primarily wants to ensure that whatever the directors decide to do in response to the bid, they act "properly". Which is to say that they act bona fide and legally in attempting to promote the interests of the company. The focal point of directors' responsibilities in any corporate control contest must be that they act, and be seen to act, with the utmost good faith towards the company. As Professor Gower points out, "[t]he general principle upon which these duties are based is clear and simple. Directors, once their appointments take effect, are fiduciaries and must therefore display the utmost good faith towards the company in their dealings with

⁹¹ Feltham, supra, note 82 at 324. Brian Cheffins in his article "Law, Economics And Morality: Contracting Out Of Corporate Law Fiduciary Duties" (1991) 19 Can. Bus. L. J. 28, said in reference to J. L. Howard's article, "Fiduciary Relations In Corporate Law", supra, note 427, "that fiduciary duties are primarily a moral concept which courts must apply to constrain potentially abusive exercise of discretion by directors and officers."

it or on its behalf." ⁹²

In the decision of the Privy Council in Cook v. Deeks (on appeal from the Supreme Court of Ontario), the Court held that, where the directors used their position as managers and the reputation of their company to secure for themselves, to the exclusion of the company, a contract, they must hold the benefits of that contract on behalf of the company. The important point to take away from the Privy Council judgment was the fact that the Court did not accept that the directors, who were in a position of control over the company, had the absolute right to decide as a question of policy, that their company was not in a position to act on the contract. ⁹³

In Regal (Hastings) Ltd. v. Gulliver, ⁹⁴ the directors of the defendant company had used their personal funds to assist in the financing of the company's purchase of shares in its subsidiary. The Court held that upon the sale of such shares any profit made belonged to the company and not to the

⁹² Supra, note 45 at 575. In Ivanhoe Partners v. Newmont Mining Corp., 535 A 2d (Del. 1987) 1334 at 1345, the court described directors' obligation in part, to be "...an affirmative duty to protect the interests of the corporation, but also an obligation to refrain from conduct which would injure the corporation and its stockholders or deprive them from profit or advantage. In short, directors must eschew any conflict between duty and self-interests."

⁹³ [1916] 1 A.C. 554 (P.C.) at 563.

⁹⁴ [1942] 1 All E.R. 378 at 389. (H.L.).

directors. This case demonstrates how important it is for directors to clearly distinguish between dealings or events that arise as a result of their connection with the company as directors, and those that are totally unconnected with the company or their office as directors. With respect to the former, the directors will be found to be in a fiduciary position vis-a-vis the company and any benefits incurred by them will be deemed to be held in trust for the benefit of the company.

The Supreme Court of Canada's decision in Canadian Aero Service Ltd. v. O'Malley, found that the duty of good faith is a composite of two important factors. One, that directors act bona fide for the benefit of the company. And, two, even though the directors may in fact have acted bona fide for the benefit of the company, they must not allow themselves to fall into a situation in which their interests may possibly conflict with those of the company.⁹⁵ However, as was pointed out by Montgomery J. in Olympia & York Enterprises Ltd. v. Hiram Walker Resources Ltd., "[i]t matters not when the directors act in the best interests of the company and in good faith that they also benefit as a result."⁹⁶ In contrast, see Exco Corporation Ltd. v. Nova Scotia Savings & Loan, where Richard J. held, (in respect to directors' powers

⁹⁵ Supra, note 47 at S.C.R. 606-07.

⁹⁶ (1987), 59 O.R. (2d) 254 at 271.

to issue shares in the context of an unsolicited takeover bid) that for the directors to discharge the burden that they had acted bona fide, "...the directors must be able to show that the considerations upon which the decision to issue [shares] was based are consistent only with the best interests of the company and inconsistent with any other interests." ⁹⁷ Richard J.'s test, it has been argued, places an untenable burden for target directors to discharge if taken to its logical conclusion. This is because any successful defence of a takeover bid, regardless of how inadequate the bid may have actually have been, would never be completely inconsistent with the possibility of self-interests. ⁹⁸

Despite the prodigious development of jurisprudence concerning fiduciary laws generally, there still exists ambivalence as to what exactly target directors should be doing in the proper execution of the duties of their office when they are responding to an unsolicited takeover bid. It has been said that, "[n]owhere are fiduciary principles applied in a more complex or difficult context than the modern corporation". ⁹⁹ La Forest J., in Lac Minerals Ltd. v.

⁹⁷ (1987), 78 N.S.R. (2d) 91, (1987) 35 B.L.R. 149 at 261 (S.C.); aff'g 79 N.S.R. (2d) 29 (C.A.).

⁹⁸ See Howard, supra, note 7 at 67; St. Patrick Baxter, supra, note 33 at 88. But see Orr, "Part II" supra, note 89 at C-16.

⁹⁹ Shepherd, supra, note 78 at 347.

International Corona Resources Ltd. declared that, "[t]here were few legal concepts more frequently invoked but less conceptually certain than that of the fiduciary relationship."¹⁰⁰ Gore-Browne On Companies can be seen to concurred with this general sentiment with respect to the present state of the law as it applies to directors as fiduciaries, where it is stated that, "[t]he form in which director's fiduciary duties are expressed is that of a number of general laws and statutory rules, varying greatly in their range of application and at many points overlapping with each other. The lack of any precise and logical pattern makes orderly exposition of these rules difficult...."¹⁰¹

Richard J. succinctly summed of his feelings on this matter in Exco Corp. v. Nova Scotia Savings & Loan Company saying that, "[t]he question of the [fiduciary] duty of a director and the considerations which are deemed proper in the execution of that duty have been the subject of myriad decisions. There appears to be no line of authority which clearly delineates the scope of the duty. Indeed, this area of the law seems to be a morass of conflicts and

¹⁰⁰ Supra, note 84, at S.C.R. 643-44. See also La Forest's comments at S.C.R. 644ff.

¹⁰¹ (Bristol: Jordan & Sons Ltd., 1984) 43rd ed. vol 2, at 27-28.

inconsistencies".¹⁰²

Acknowledging that a director is a fiduciary is only a start to a far more complex question. It was once espoused that, "...to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations?" And what are the consequences of his deviation from duty?¹⁰³

Finally, Michael St. Patrick Baxter referred to the status of a director as fiduciaries as lacking in meaning and was simply an amorphous concept.¹⁰⁴ In support of this proposition, Mr. St. Patrick Baxter cites the comments made by P.D. Finn that, "the term "fiduciaries" is itself one of the most ill-defined, if not misleading terms in our law."¹⁰⁵

¹⁰² Supra, note 97 at B.L.R. 255-56, at A.P.R. 161. See also Orr, "Part I" supra, note 75 at C-3.

¹⁰³ Per Mr. Justice Frankfurter, Securities and Exch. Comm'n v. Chenery Corp., (1942) 318 U.S. 80, at 85-6.

¹⁰⁴ Supra, note 33 at 66.

¹⁰⁵ Ibid. at note 17.

CHAPTER THREE

THE "PROPER" EXERCISE OF DIRECTORS' POWERSTHE TECK TEST APPROACH

One question that has pre-occupied the courts over the years, is how to ensure that unscrupulous directors are not easily able to pervert the use of their authority for their own personal welfare or for the interests of person or persons unconnected with the company and the legitimate rights of shareholders.

As a general rule, it has not been practical for the courts to try and set out with any real degree of specificity, how, when and where the powers afforded directors are to be used.¹⁰⁶ However, when called upon to adjudicate cases where it has been alleged that directors were abusing their powers, the Anglo-Canadian judiciary has maintained an approach encompassing not only traditional fiduciary notions, but also, it has sought to limit the ambit of the impugned power within defined limits. This was done by the courts attempting to assess the use of the power within a rigid analytical framework which seeks firstly, to categorize

¹⁰⁶ See Howard Smith Ltd. v. Ampol Petroleum Ltd., *supra*, note 41 at A.C. 835; at 1 All E.R. 1134.

whether the type of power exercised was a power conferred upon the directors, and if so, whether the it was utilized for the purpose for which it was granted. ¹⁰⁷ Under this approach, regardless of whether the directors acted in a manner which they honestly considered to be in the best interests of the company, if they exercise their powers outside of these perceived limits, their actions would be struck down as being improper. ¹⁰⁸ This juridical approach to assessing the propriety of directors conduct is generally referred to as the "proper purpose test" or "proper purpose rule". ¹⁰⁹

In one way, the "proper purpose test" would appear to be a rather convenient and manageable approach for the judiciary to take in attempting to keep the exercise of directors'

¹⁰⁷ See generally, Hadden, supra, note 14, at 587-89; Welling, supra, note 42 at 336-356; Farrar, supra, note 1 at 27ff; St. Patrick Baxter, supra, note 33 at 77-88; B. V. Slutsky, "Canadian Rejection Of The Hogg v. Cramphorn "Improper Purpose" Principle - A Step Forward?" (1974) 37 Mod. L. Rev. 457.

¹⁰⁸ Whether or not the company's shareholders can vote to "approve" a so-called improper exercise of directors' powers is a matter of some debate and will not be further addressed here. See generally S. M. Beck, "The Shareholders' Derivative Action" [1974] Can. Bar Rev. 159 at 175; Iacobucci, "Canadian Business" supra, note, 14, at 298 & note 302; Iacobucci, supra, note 7 at 163- 64; Welling, supra, note 42 at 430 & note 416.

¹⁰⁹ It has also been referred to as the proper purpose doctrine, and the collateral purpose rule, see F.Iacobucci, "The Exercise of Directors' Powers: - The Battle of Afton Mines", (1973) 11 Osgoode Hall L. J. 353 at 364.

powers in check.¹¹⁰ No doubt, directors must be required in the execution of their duties to act properly, however one can question whether the "proper purpose test" is an appropriate, or probative means of trying to assess the propriety of directors' conduct when responding to a corporate control situation such as an unsolicited takeover bid.¹¹¹ Berger J., in deciding the now famous case of Teck Corporation Ltd. v. Millar, felt that it was not.¹¹²

Teck marked a major turning point, at least in Canadian jurisprudence, in considering the role of directors in managing the business and affairs of a company in corporate control contests. In rejecting the more restrictive "proper purpose test" approach, Berger J. argued that deciding whether or not the actions taken by a director were "proper" or "improper", was better understood within the construct of traditional considerations of the directors' duty of good faith. Under this approach, directors will act for an improper purpose only if they are not genuinely, "bona fide" motivated

¹¹⁰ See Slutsky, supra, note, 107 at 460.

¹¹¹ See Welling, supra, note 42 at 338-39 & note 126.

¹¹² Supra, note, 42 at D.L.R. 307-317, at W.W.R. 404-416 Professor Welling strongly concurs with the rejection of the "proper purpose test", see supra, note, 42 at 355. See also Slutsky, supra, note 107 at 460. But see Orr, "part II", supra, note 89 at C-17. Interestingly, the approach taken by Berger J. in Teck had been addressed previously in Canada by Harvey C. J. A. in Spooner v. Spooner Oils Ltd., [1936] 2 D.L.R. 634 at 636, [1936] 1 W.W.R. 561 at 562 (Alta. S.C.A.D.).

in taking the course of action they did, for the primary purpose of advancing the best interests of the company.¹¹³

Briefly, the facts in Teck are that a company called Afton Mines, "a junior" mining resource company, was in the process of developing its Kamloops copper mining property. In order to do this, it had to eventually enter into an arrangement with a more established mining company, "a major", which possessed the financial and technical wherewithal necessary to bring their property into production. (Such an arrangement is referred to in the industry as the "ultimate deal".) After considering Bethlehem Copper Ltd., Afton eventually began negotiations with Placer Developments Ltd., as its best option, thereby rebuffing Teck's, solicitations for the "ultimate deal". Undeterred, Teck continued to

¹¹³ Although broadly embraced as a progressive judgment, there is one particular aspect of the Teck decision which gives occasion to some criticism. This being that Berger J. found it appropriate that the initial burden of proof that the directors did not act bona fide, be first discharged by the plaintiff. An alternative approach would be to shift onto the shoulders of the target directors the initial burden of proof that they acted properly in employing the defensive tactics they did. This approach has a certain intuitive and logical appeal to it as it recognizes the inherent potential for self-dealing on the part of unscrupulous directors when responding to an unwelcome takeover bid, and removes the potential inequities of establishing too onerous a burden for a complainant shareholder that could bar any effective remedy. This approach has in the context of defensive tactics implemented in the context of an unsolicited takeover bid by the target directors, generally gained acceptance in a number of states in the U.S., and was advanced here in Canada in Exco Corporation Ltd. v. Nova Scotia Savings & Loan, supra, note 97.

purchase shares of Afton on the open market in order to obtain effective control of the company, after which Teck would elect individuals of its choosing onto Afton's board of directors.

The issue at trial was, that before Teck could make good on its plans at the upcoming special shareholders' meeting it had called, the directors of Afton entered into the "ultimate deal" with Placer. In order to ensure that Teck could not interfere with these arrangements, a block of Afton's shares were issued to Canadian Exploration Ltd. ("Canex") a wholly-owned subsidiary of Placer, thereby rendering Teck into a minority position. Teck brought a derivative suit against Afton's board of directors to have the share issuance to Canex rendered null and void, ¹¹⁴ on the grounds that Afton's directors had acted for the improper purpose of attempting to affect control within the company. Given the Anglo-Canadian case law precedent up to this point, Teck's position was completely tenable. ¹¹⁵ Based on prevailing case law it should not have mattered that Afton's directors bona fide believed that the Placer deal would be better for their company than a similar deal with Teck. 116(a)

¹¹⁴ On this point see the comments of Professor Slutsky, supra, note 107 at 458.

¹¹⁵ See Welling, supra, note 42 at 343.

Instead, Berger J. found that Afton's directors had the responsibility to manage the business and affairs of the company as they saw fit until such time as they were removed from office,¹¹⁶ therefore Afton's directors were, "...entitled to consider the reputation, experience and policies of anyone seeking to take over the company. If they decide, on reasonable grounds, that a take-over will cause substantial damage to the company's interest, they are entitled to use their power to protect the company."¹¹⁷ Berger J. derived support for his conclusion from the judgment rendered in Smith v. Fawcett Ltd.¹¹⁸ stating that:

The impropriety lies in the directors' purpose. If their purpose is not to serve the company's interest, then it is an improper purpose. Impropriety depends upon proof that the directors were actuated by a collateral purpose; it does not depend upon the nature of any shareholders' right that may be affected by the exercise of the directors' powers.¹¹⁹

116(a) Despite Afton's preceptions of Teck 's business accumen in the mining industry, Teck's corproate performance has been favourable over the years since, doubling its assets to \$1 billion between 1980 -89 and tripling its profits. E. Clifford "Teck shares not in bargain territory yet" The Globe & Mail (26 feb. 1992) B 7.

¹¹⁶ Teck, supra, note 53 at D.L.R. 330, at W.W.R. 429-30.

¹¹⁷ Ibid. at D.L.R. 317, at W.W.R. 415-16.

¹¹⁸ Supra, note 40 at 306.

¹¹⁹ Teck, supra, note 53 at D.L.R. at 312, W.W.R. 410-11.

Berger J. also determined that within the mining industry, "ultimate deals" inevitable involve a junior issuing to a major, a significant proportionate percentage of its shares, and that the dilution of Teck's position was only incidental to Afton's board of directors' primary objective to secure the best possible deal for the company. ¹²⁰

In determining whether the directors acted bona fide in the actions they took, Berger J. required that there be demonstrable evidence - **reasonable grounds**, that the perceived threat posed to the company would cause **substantial damage** to its interests. ¹²¹

Based on the approach taken by Berger J. in Teck, one might expect that an argument could be fashioned, that when faced with an unsolicited takeover bid which, on reasonable

¹²⁰ Ibid. at D.L.R. 329-331, at W.W.R. 429-31. Berger J.'s reference to "primary purpose" was necessary to distinguish Teck from cases like Hogg v. Cramphorn, supra, note 73, where it was found the directors had issued shares in their companies primarily for the purpose of altering control. See Howard, supra, note 7 at 64-65.

¹²¹ With respect to Berger J.'s "reasonable grounds" test, Professor Slutsky, supra, note 107 at 460-61, advocates what he describes as a more flexible judicial approach for determining the propriety of director's conduct in responding to certain corporate control events. In particular, Professor Slutsky argues that the implementation of the equitable principle of "conflict of interest and duty" may, because its objective qualities, be a superior test to use. This however raises the question - what about those corporate incidents where the company's best interests would only be served if its directors took steps necessarily placing them in a conflict of interests and duty-type situation?

grounds, has been determined would cause substantial damage to the interests of the company, the board of directors of the target company should be able, in the proper execution of the powers of their office, to take whatever means are reasonably necessary to repel the perceived harm from materializing. Whether at present such an argument would prevail in Canada is a matter of some doubt. Although Teck has been referred to or applied in a number of cases,¹²² the Privy Council in the case of Howard Smith Ltd. v. Ampol Petroleum Ltd., while it approved of Teck, seemed to indicate that the decision was unique to the special facts of the case, and that the proper purpose test, albeit a somewhat attenuated version to that applied in cases like Hogg v. Cramphorn Ltd., or Bamford v. Bamford,¹²³ was still a viable judicial doctrine.¹²⁴ As well, in the fairly recent Canadian case of Exco Corporation

¹²² Applied in: Shield Development Co. v. Sndyer [1976] 3 W.W.R. 44 at 62-4; Olson v. Phoenix Industrial Supply Ltd. (1984) 27 Man. R. (2d) 205 at 209 (Man. C.A.); Re Olympia & York Enterprises Ltd. v. Hiram Walker Resources Ltd. (1986) 59 O.R. (2d) 254 at 268, 271-2, 37 D.L.R. (4th) 193 at 207, 210-11 (Ont. Div. Ct.), aff'd (1986) 59 OR (2d) 280, 37 D.L.R. (4th) 219 (Div. Ct.) Referred with approval in: Re Royal Trustco Ltd (No. 3) (1981) 14 B.L.R. 307 at 314-15 (Ont. H.C.); Dixon v. Mereland Exploration Ltd. (1984) 50 A.R. 353 at 361-2; Northern & General Gas Co. v. Hillcrest Collieries Ltd. (59 D.L.R. (3d) 533, [1976] 1 W.W.R. 481 at 551; and First City Financial Corp. Ltd. v. Genstar Corp. (1981) 125 D.L.R. (3d) 30, 33 O.R. (2d) 631 (H.C.).

¹²³ Supra, note 73; [1968] 2 All E.R. 655 aff'd [1969] 1 All E.R. 969 (C.A.), respectfully.

¹²⁴ See the comments of Lord Wilberforce, in Howard Smith v. Ampol Petroleum Ltd., supra, note 41, at All E.R. 1135, at A.C. 836-37.

Ltd. v. Nova Scotia Savings & Loan Co., Richard J., in approving of Howard Smith v. Ampol Petroleum Ltd., distinguished Teck and stated that, "I am of the view, however, that the pronouncements in Teck go beyond what was required to decide that case. On a careful review of the facts it appears to me that what was under consideration there was a very unusual set of facts which must be somewhat unique to the mining industry." ¹²⁵

J. Geoffrey Howard, in his article, "Takeover Defences: A Reappraisal", argues that the decision reached in Exco was "totally inconsistent" with the judgment rendered in Teck. ¹²⁶ J. Geoffrey Howard maintains that there exists in Canada a vacuum of authoritative precedent as to what is the appropriate role for directors in responding to takeover bids generally. ¹²⁷ John H. Farrar in his article, "Business Judgment And Defensive Tactics" also points out that, "Berger J. in Teck had referred to the inconsistency in earlier Canadian authority. Exco casts doubt on Teck and emphasizes the lack of coherence in the Canadian authorities." ¹²⁸ Frank Iacobucci concluded his article, "The Exercise Of

¹²⁵ Supra, note 97 at B.L.R. 263-64, and see the comments of Richard J. at B.L.R. 258-259.

¹²⁶ Supra, note 7 at 63.

¹²⁷ Ibid. at 74.

¹²⁸ Supra, note 1 at 34. See also St. Patrick Baxter, supra, note 33 at 86-87.

Directors' Powers: - The Battle Of Afton Mines" advising the reader that the issuance of shares to thwart a takeover bid, outside of a factual situation similar to that in Teck, would be exceptional. The validity of such a share issuance would have to be grounded in the existence of unequivocal evidence that the best interests of the corporation would be served.

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It is to this issue - "the best interests of the company", and to what may be said to be the "appropriate" role of target directors in endeavouring to promote the best interests of the company when responding to an unsolicited takeover bid, that will be discussed next.

¹²⁹ Supra, note 109 at 372.

CHAPTER FOUR - PART I

THE "APPROPRIATE" ROLE OF A BOARD OF DIRECTORS
IN RESPONDING TO AN UNSOLICITED TAKEOVER BID

With respect to publicly traded companies in Canada, what is, it may be asked, the "appropriate" role of a board of directors in responding to an unsolicited takeover bid? Better, it may be queried whether there is such a thing as an "appropriate" role which directors are obliged to conform to when confronted with an any corporate control situation. Is it more reasonable to conclude that because of the varied complexities of corporate management, a discussion of how a board of directors ought to respond to an unsolicited takeover bid must by necessity, be limited to broad generalities of duties and obligations?

The role of corporate directors is typically prescribed in law expansively. With limited exceptions when it comes procedural matter, ¹³⁰ little changes when a company becomes the subject of an unsolicited takeover bid. Notwithstanding the diversity of character with respect to a corporation's

¹³⁰ In particular disclosure requirements, early warning devices, minimum bid period, withdrawal rights, pro rate take-up, increased consideration, control block purchase, and stock exchange rule where applicable.

interests, or the vagaries of directors' duties and obligations, it is proposed that in the context of an unsolicited takeover bid, both the interests of a company and the "appropriate" role of the company's board of directors in responding to the takeover bid are amenable to a certain degree of specificity.

At the outset of chapter two, it is proposed that despite the alienability of shares generally, a board of directors in the proper execution of their duties to manage the business and affairs of the company, should have the ability to respond to an unsolicited takeover bid where in the opinion of the board, it would be in the interests of the company to do so.

There are a number of intriguing questions that present themselves when one begins to address the various incidental matters associated with the concept of target directors responding to an unsolicited takeover bid they perceive not to be in the interests of the company. What are these "best interests" that the directors are charged with having to promote? How are they defined? To whom are they owed? What, if any, are the confining business principles or parameters of relevancy that should be applied in determining what is in the interests of the company?

Of all the possible questions one might encounter in the

discussion of this topic, none appears to be more relevant than the consideration of what is properly understood by the phrase, "the best interests of the company". It is precisely how we interpret the phrase, "the best interests of the company" that is central to how we perceive what the role of directors should be in responding to an unsolicited takeover bid. ¹³¹

If there were an emerging consensus of opinions as to what is meant by this phrase, that consensus would be that the directors owe their fiduciary obligations in law to the company, and "the company" is best understood to mean the interest of the shareholders as a whole. In turn, the interests of the shareholders as a whole has been interpreted to mean maximizing shareholder value. ¹³² Whether or not it can be said that there is a developing consensus being reached in respect of this issue, the fact remains that there is a perceptible measure of confusion in Canada surrounding this issue. Much of the difficulty springs from ambivalence associated with the expression "the best interests of the

¹³¹ See St. Patrick Baxter, supra, note 33 at 69, who echoed these same sentiments in his article where he stated, "... in the determination of whether target directors have discharged their fiduciary obligations, the defensive measures of target directors should be judged in light of both the interests that the directors are required to protect and the interests that they in fact sought to protect."

¹³² See Iacobucci, "The Exercise of Directors' Powers:- The Battle of Afton Mines", supra, note 109 at 353-54.

company".¹³³ Michael St. Patrick Baxter commented that this issue, more than any other in this field of law, remains shrouded in an astonishing array of vague judicial and theoretical generalities. St. Patrick Baxter states that, "[u]nlike the American experience, there are not many Canadian cases dealing with directors' fiduciary obligations in resisting an unsolicited takeover bid. Of those few cases on point, even fewer of them have thoughtfully addressed the issue."¹³⁴

Charles R. Spector, pointed out that:

One striking factor in examining Directors' responsibilities in the context of a hostile takeover in Canada is the paucity of appropriate case law. ...While there is no shortage of literature outlining the duties of Directors of Canadian corporations in general, the development of governing principles in evaluating and determining Directors' duties in the context of a hostile takeover is still in its embryonic stage.¹³⁵

In their text Canadian Business Corporations An Analysis Of Recent Legislative Developments, Frank Iacobucci, Marilyn L. Pilkington, J. Robert S. Prichard, have remarked that, "[t]here is some difficulty in determining what are the best interests of the company or, in other words, what kinds of

¹³³ Harper, supra, note 62 at 449.

¹³⁴ St. Patrick Baxter, supra, note 33 at 76.

¹³⁵ Supra, note 11 at 143.

considerations directors are entitled to take into account in reaching a decision." ¹³⁶

¹³⁶ Supra, note 14 at 295. See also Sommer, supra 56 at 46-56; Shepherd, Supra, note 78 at 347.

CHAPTER FOUR - PART II

WHOSE BEST INTERESTS?TO WHOM ARE DIRECTORS OBLIGATIONS OWED?

It has become an axiom to say that a director must act bona fide in the best interests of the company. However, where directors are called upon to respond to an unsolicited takeover bid, to say that he or she must act bona fide in the best interests of the company without further exposition is woefully inadequate and unlikely to instill much in the way of understanding as to what this responsibility exactly entails.

What is meant, one might query, by the phrase "the best interests of the company". What are these "best interests" of the company that directors are charged with the obligation of having to promote? Should directors construe what is meant by the "best interests of the company", solely from the perspective of how a particular decision on their part is likely to affect the company as a commercial entity separate and apart from any concerns as to what affect such a decision may have on the shareholders? Alternatively, should directors consider the corporation and its shareholders as separate but equally deserving entities of their consideration? Or is it better understood that "the company" and "the shareholders" are one and the same, and that reference to one automatically

subsumes the other? ¹³⁷

In discussing the proper execution of directors' fiduciary obligations, Michael St. Patrick Baxter was of the opinion that, "...the root of the difficulty lies in the fact that the Canadian case law has not articulated the duties of a director in evaluating and responding to a takeover bid. Consequently, it is difficult to determine what target directors have to do in order to satisfy their fiduciary obligations." ¹³⁸

When discussing the appropriate role of a board of directors in responding to an unsolicited takeover bid, the notion that directors are fiduciaries is not per se, the prominent issue, but rather, how as fiduciaries are directors to properly execute their duties and obligations. One question that is likely to be forthcoming from any director whose company has become the target of an unsolicited takeover bid is, to whom does his or her obligations as a director lie?

¹³⁷ Other considerations directors may have, may be:

- what are the parameters of their authority when considering what may or may not be in the best interests of the company
- must the interests of the company be identifiable with the interests of the shareholders
- can the interest of a company be distinct from its shareholders
- if the interests of the company and the shareholders are at odds, which of the two conflicting interests should prevail
- is the preservation of the corporation's existing character a legitimate concern of the directors

¹³⁸ Supra, note 33 at 105.

That is, in attempting to determine what is in the best interests of the company, to whom is it appropriate for the directors to look in evaluating the efficacy of a potential response? Put another way, "[i]f I am a trustee, [of a corporation] who are the beneficiaries of the trust? To whom do I owe my obligations?" ¹³⁹

Despite criticism to the contrary, ¹⁴⁰ it has been said, that the judgment rendered in the case of Percival v. Wright ¹⁴¹ stands as authority that directors owe no fiduciary obligation to the shareholders as a general rule of law. Mahon J. stated in the case of Coleman v. Myers, that, "[i]n every ordinary aspect of the administration of the affairs of a limited company it is essential that the directors be fiduciary agents of the company alone. The concept of corporate management would collapse if there was any general rule that the directors were also fiduciary agents of the shareholders. ¹⁴²

In the case of Percival v. Wright, the directors of a

¹³⁹ Dodd, supra, note 37 at 1154, quoting from the text of a speech given by a Mr. Owen D. Young.

¹⁴⁰ See generally the comments of Mahon J. in Coleman v. Myers, [1977] 2 N.Z.L.R. 225 (N.Z.S.C.) at 268-274; Gower, supra, note 45 at 573-74. Shepherd, supra, note 78 at 355-56 & note 31.

¹⁴¹ [1902] 2 Ch. D. 421, 18 T.L.R. 697.

¹⁴² Supra, note 140 at 273. See also infra note 253 & accompanying text.

company, (Nixon's Navigation Company, Ltd.) at the initiation of certain executors of a deceased shareholder, entered into an arrangement whereby the executors sold shares of the company back to the directors. The directors however neglected to inform the executors that they were simultaneously negotiating a possible deal to sell the company, which as the executives later argued, was a breach of the directors' fiduciary obligations owed to them. Swinfen Eady J., held that:

It was strenuously urged that, though incorporation affected the relations of the shareholders to the external world, the company thereby becoming a distinct entity, the position of the shareholders inter se was not affected, and was the same as that of partners or shareholders in an unincorporated company. I am unable to adopt that view. I am therefore of the opinion that the purchasing directors were under no obligation to disclose to their vendor shareholders the negotiations which ultimately proved abortive. The contrary view would place directors in a most invidious position, as they could not buy or sell shares without disclosing negotiations....

There is no question of unfair dealing in this case. The directors did not approach the shareholders with the view of obtaining their shares. The shareholders approached the directors, and named the price at which they were desirous of selling. ¹⁴³

A brief review of some of the leading academic commentators, and of various articles makes the point made by Swinfen Eady J. unmistakably clear:

¹⁴³ Supra, note 141 at 426. See also the comments made by Lord Atkin in *Bell v. Lever Bros. Ltd.* [1932] A.C. 161, at 228 (H.L.).

Professor Gower points out that, "...the fiduciary duties [of directors] are owed to the company and to the company alone. ...Here it is suffice to emphasise that, in general, the directors owe no duties to the individual members as such, or, a fortiori, to a person who has not yet become a member—such as a potential purchaser of shares in it. This principle is regarded as firmly established by the much-criticised decision in *Percival v. Wright*." ¹⁴⁴

Professor Welling has stated that, "...legal theory has personified the economic enterprise within which corporate managers work. This has the effect of making directors and officers responsible for the funds contributed by, and the business aspirations of, shareholders and creditors without making them directly responsible to these people as a matter of legal obligation." ¹⁴⁵

Gore-Browne On Companies similarly states that, "[i]t is an established general rule that, in so far as a director of a company is bound by fiduciary duties at general law, these duties are owed to the company only. ...they are not owed to

¹⁴⁴ Supra, note 45 at 573. With regarded to Professors Gower's statement that their is no duty owed to "potential purchaser of shares" see Gower, "Corporate Control: The Battle For The Berkeley supra, note, 55 at 1188-89.

¹⁴⁵ Welling, supra, note, 42 at 297-98.

the individual shareholders of the company..."¹⁴⁶

In the article, "The Oppression Remedy In Corporate Law: The Canadian Experience", author Brian Cheffins remarked that, "the general rule was, and continues to be, that directors owe fiduciary duties to the corporation and not to shareholders directly."¹⁴⁷

Charles C. Spector in his article, "Takeovers And The Duties Of The Board Of Directors: Comparative Aspects Of American And Canadian Standards", commented that, "[t]here is also a fundamental difference between Canadian and American corporate statute in that in Canada the fiduciary duty of Directors is owed to the Corporation and not expressly to its shareholders."¹⁴⁸

The notion of the directors owing their fiduciary duties solely to the company is, at least in part, premised upon two inter-related propositions of law, the first of which is the agency principle. A company is by obvious necessity, only able to act within the world and to conduct its business and affairs through individuals. Those who act on the behalf of

¹⁴⁶ A. J. Boyle & R. Sykes, Gore-Browne on Companies, (Bristol: Jordan & Sons Ltd., 1984) at para. 27-8.

¹⁴⁷ Supra, note 58 at 307.

¹⁴⁸ Supra, note, 11 at 150.

the company are in law, agents of the company. Both Professors Gower and Welling speak of the necessary role played by a board of directors in transacting corporate affairs.¹⁴⁹ "[The company] remains an artificial person and can of necessity act only through the agency of natural persons."¹⁵⁰ Traditionally a company's board of directors is its primary agent. In law agents owe their legal obligations to their principle - translating this into the corporate scenario, a company's board of directors owes its duties as agent to the corporate entity as its principal, a fortiora, not to the shareholders.

The concept of directors as mere agents or servants of the company is itself, if taken literally, somewhat misleading. It has been argued that directors are not simply mere agents for their company, but more so, the board of directors should be seen as the embodiment of the company's will, making, not simply carrying out, company policy. John L. Howard would argue that, "... directors of a corporation are in fact and at law a decision-making organ of the corporate body. They clearly are not agents and only in extraordinary circumstances could a director bind the

¹⁴⁹ See generally, supra, note 42; supra, note 45.

¹⁵⁰ Supra, note 45 at 139. See also the statement of Lord Selbourne in Gt. Eastern R. R. Co. v. Turner, (1872/3) 8 Ch. App., 149. at 152; "The directors are the mere trustees or agents of the company..."

corporation to a contract other than through the board's collegiate process." ¹⁵¹

"Nor are directors to be construed as simple agents of the legally personified corporate entity", Professor Welling once commented. ¹⁵² "They will from time to time operate as agents of the corporation, in the sense that most corporate activity is perceived by the outside world as having been accomplished through the mechanism of human intervention. They are, however, not simply agents doing the bidding of an omnipotent, though absent, principal. They must exercise their powers for the benefit of the corporation, but it is they who determine what the corporation wished to be done".

¹⁵³

Coupled with the agency principle, is the fact that the courts had traditionally perceived the duties and obligations of directors as being derived from traditional trust law

¹⁵¹ Supra, note 42 at 9.

¹⁵² Supra, note 42 at 299.

¹⁵³ Ibid. See also the remarks of Sir Richard Collins, M.R. in Automatic Self-Cleansing Filter Syndicate Co., Ltd. v. Cunningham, supra, note 64 at 41-42, "It has been suggested that this is a mere question of principal and agent, and that it would be an absurd thing if a principal in appointing an agent should in effect appoint a dictator who is to manage him instead of his managing the agent."

jurisprudence.¹⁵⁴ As such, courts were apt to see directors as owing their duties to a single beneficiary, that being the corporation. Professor Gower points out however, that:

It is often stated that directors are trustees and that the nature of their duties can be explained on this basis. It is easy to see how this idea arose. Prior to 1844 most joint stock companies were unincorporated and depended for their validity on a deed of settlement vesting the property of the company in trustees. Often the directors were themselves the trustees... .

With directors of incorporated companies the description "trustees" was less apposite but it was not unnatural that the courts should extend it to them by analogy. ... courts of equity always tend to apply the label "trustees" to anyone in a fiduciary position. Nevertheless, to describe directors as trustees seems today to be neither strictly correct nor invariably helpful. In truth, directors are agents of the company rather than trustees of it or its property.¹⁵⁵

The second proposition as to why in law directors owe their duties to the corporate entity and not to the shareholders, can be said to be the historical preoccupation of the courts to reaffirm what was an emerging doctrine of limited liability and the notion that an incorporated company

¹⁵⁴ See J .L. Howard, "Fiduciary Obligations", supra, note, 58 at 3.1.07-08; Dodd, supra, note 37 at 1146 & note 1 referring to Hohfeld's article, "The Individual Liability of Stockholders and the Conflict of Laws" (1909) Col. L. Rev. 492, "The laws that today attempt to regulate the duties and responsibilities of corporate directors were derived from trust law."; Shareholders' and Directors' Right, The Law Society Upper Canada, Dec 10, 1983.

¹⁵⁵ Supra, note 45 at 571-72.

was in law a distinct person, separate and apart from its incorporators.¹⁵⁶ Consequently the law refused to consider directors as owing any kind of fiduciary obligations to shareholders; the corporation stood between the shareholders and the directors as the proper recipient of directors' duties and obligation. It was the corporation that was the one who could legitimately complain to the courts for alleged abuses or breaches of directors' duties.

Gerald Gillerman surmised that, the establishment of the notion that the directors owe their obligations to the "corporate entity" and not to the shareholders, may lie in the fact that we have placed so much emphasis in the past on the corporation being perceived "...as a distinct person in law...The corporation was viewed as an ideal body, subsisting only in contemplation of law:..."¹⁵⁷

Strictly from an etymological perspective, the statutory requirement that directors are to discharge their duties with a view to the best interests of the company is intriguing. The operative words being, "the company". Intuitively, the plain meaning of this phrase in the context of an unsolicited

¹⁵⁶ See Shepherd, supra, note 78 at 350 & note 9, 355-56. See e.g. Salomon v. Salomon [1897] A. C. 22; Pratt v. Bacon 10 Pick 123, 125-126 (1830), Smith v. Hurd 12 Met. 371, 384 (1847).

¹⁵⁷ "The Corporate Fiduciary Under State Law" (1980) 3 The Corp. L. Rev. 299 at 300-01.

takeover bid is that that directors of the target company are to consider the implications of the bid solely on the basis of how it would affect the interests of the company as a commercially viable going concern independent from considerations as to how such an event might impact on the interests of the shareholders.¹⁵⁸ This however, is not the equitable understanding that this phrase has been given. To accept that directors can ignore the interests of their shareholders to perpetuate some variant interest of the company appears to fly against common sense, disregarding the logical nexus between a company and its shareholders. Professor Louis Loss, described such an interpretation of directors obligations as "a monument to the ability of lawyers to hypnotise themselves with their own creation."¹⁵⁹

The reality of the situation is that the company is simply the embodiment of its shareholders through the use of legal fiction. The corporation is in essence, merely the aggregate of all of its shareholders. "The classical theory is that the directors' duty is to the company. The company's

¹⁵⁸ Harper, supra, note 62 at 449.

¹⁵⁹ "The Fiduciary Concept as applied to Trading by Corporate "Insiders" in the United States" (1970) 33 Mod. L. Rev. 34 at 40-41, as cited in St. Patrick Baxter's article, supra, note 33 at 71 & note 42.

shareholders are the company:..."¹⁶⁰ Directors are not simply seen as the guardians of the corporation's purse, in considering the best interests of the company, the directors are required to consider the interests of the shareholders. It is suggested that it is the interests of the shareholders that both confines and defines the duties of directors. More specifically, as will be discussed below, it is the legitimate interests of the shareholders that can be said to be the determinative factor in establishing the appropriate role of directors in responding to an unsolicited takeover bid, or to any corporate control situation for that matter. A. A. Sommer put it succinctly when he stated:

The best interests of the corporation would be a difficult measure by which to judge the conduct of directors, and the enforcement of such a responsibility would be nigh impossible. Virtually any action could in some fashion be justified as in the interests of the corporation, unless shareholder interests were a confining principle.¹⁶¹

If the best interests of company is properly understood to mean the best interests of the shareholders, is it an interest that is shared by the shareholders as a whole? If so, what is this singular interest unique to all the shareholders? Alternatively, should the directors be

¹⁶⁰ Per Berger J., in Teck, supra, note 53 at 313, referring to the decision of Boyd C., in Martin v Gibson (1907), 15 O.L.R. 623 at 632. See however Richard J.'s comments in Exco, supra, note 97 at 261.

¹⁶¹ Supra, note, 55 at p. 54.

considering the interests of each shareholders individually? If this is the case, what are directors to do if individual interests of the shareholders conflict? Should the directors endeavour to strike a balance between conflicting interests, responding to a takeover bid in a manner that they determine to be the most equitable? Arguably, it is the interests of the shareholders as a whole, that is the relevant issue for the directors to attend to when considering how to respond to an unsolicited takeover bid.

The principle that it is the welfare of the shareholders as a whole that should legitimately be the concern of directors in determining corporate policy was well established in the case of Allen v. Gold Reefs of West Africa, Ltd.¹⁶² In this case, the English Court of Appeal sanctioned the appellate company's passing of a special resolution. The impugned resolution altered the articles of the company so that a lien could attach against a shareholders' fully paid shares, for shares held that were not paid in full. The Court held that where such alterations of a company's articles was made in good faith, it was not open for shareholders (in this case the executors of a deceased shareholder) having purchased their shares knowing of the company's powers to alter its articles, to complain if such an alteration was later made. With respect to the company's power to alter its articles, and

¹⁶² [1900] 1 Ch. D. 656 (C.A.) at 671.

indeed of all company's powers, Lindley M.R., stated:

The power thus conferred on companies to alter the regulations contained in their articles is limited only by the provisions contained in the statute and the conditions contained in the company's memorandum of association. ...the power conferred... must, like all other powers, be exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind minorities. It must be exercised, not only in the manner required by law, but also bona fide for the benefit of the company as a whole, and it must not be exceeded." (emphasis mine.) ¹⁶³

Byrne J., reaffirmed the above noted statement of Lord Lindley in Punt v. Symons & Co., Ltd. ¹⁶⁴

Greenhalgh v. Arderne Cinemas, Ltd., ¹⁶⁵ a case involving the sale by the majority of their interests in a company (Arderne Cinemas), the minority shareholders sought to stop the transaction on the grounds the terms of the sale resulted in the perpetration of fraud upon them, in that a fee was to be payable out of the company's own resources to certain departing management recipients as a consequence of the sale. Further it was argued that the planned sale would not advance the interests of the company, rather it would only hurt the interests of the minority shareholders. Lord

¹⁶³ Ibid. at 671.

¹⁶⁴ [1903] 2 Ch. D. 506 at 512.

¹⁶⁵ [1950] 2 All E.R. 1120; [1951] Ch. D. 286. (C.A.).

Evershed M.R., disagreeing with the findings at trial that the terms of the sale amounted to fraud upon the minority, turned his attention to the authority of the board of directors to alter the articles of the company in the bona fide exercise of their powers. Evershed M.R., stated that, "...'bona fide for the benefit of the company as a whole' ...the phrase, 'the company as a whole', does not (at any rate in such a case as the present) mean the company as a commercial entity as distinct from the corporators. It means the corporators as a general body." ¹⁶⁶

Plowman J., in Parke v. Daily News Ltd., also recognized that, as in the case of Greenhalgh v. Arderne Cinemas Ltd., that what is meant by the benefit of the company is, the benefit of the shareholders as a general body. ¹⁶⁷

In Martin v Gibson, Boyd, C. stated, "[n]ow, the persons to be considered and to be benefitted are the whole body of shareholders ...all in fact who, being shareholders, constitute the very substance (so to speak) of the incorporated body." ¹⁶⁸

Academics and commentators have reaffirmed that the

¹⁶⁶ Ibid., at p. 1126.

¹⁶⁷ Supra, note 51 at W.L.R. 594.

¹⁶⁸ Supra, note 160 at 632.

directors are to strive to promote the interests of the shareholders as a whole. In Palmer's Company Law text, it states that:

Directors are under a duty to act bona fide in the best interests of the company. Although directors' duties are owed primarily to, and are enforceable by, the company and not to individual shareholders, the company is defined in equity usually by reference to the shareholders as a whole and not by reference to the company as an entity distinct from its members.¹⁶⁹

Professor Robert Pennington, commented that, "Directors' powers are given to them to be used for the benefit of the company, that is the benefit of the shareholders as a whole ..."¹⁷⁰

Professor Berle wrote that, "[b]ut where powers are conceded to the management...to act for the corporation as a whole, the obvious, if tacit, assumption is that these powers are intended to be used only on behalf of all. They are distinctly not intended to be granted for the purpose of benefiting one set of participants against another. To do so would be to violate every intendment of the whole corporate situation."¹⁷¹

¹⁶⁹ (Sweet & Maxwell: London, 1992) Vol. No. 1, at 8104.

¹⁷⁰ R. Pennington, Company Law, as cited in A. A. Sommer's article, "Whom Should The Corporations Serve? supra, note 55 at 48.

¹⁷¹ Supra, note 37 at 1073.

Although Professor Gower is not as adamant that the interests of the company strictly equates to the interests of the shareholders as a whole, he generally expresses similar sentiments on this point stating, "[b]ut what exactly is meant by saying that they [directors] must act in the interests of the company? Despite the separate personality of the company it is clear that directors are not expected to act on the basis of what is for the economic advantage of the corporate entity, disregarding the interests of the members".¹⁷² (emphasis Gower's)

In the context of a takeover bid, it is advanced that the status quo remains constant, that is, the best interests of the company continues to properly be understood to mean the interests of the shareholders as a whole. John Stransman and Anthony A. Greenwood, have stated the best interests of the corporation means, [i]n the context of take-over bid scenarios, ... the best interest of all its shareholders."

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¹⁷² Supra, note 45 at 577. See also Gower, "Corporate Control: The Battle For The Berkeley", supra, note 55 at 1188-89.

¹⁷³ "Appropriate Actions for Directors", supra, note, 43 at 62.

CHAPTER FOUR - PART III

POTENTIAL CONFLICT OF DIRECTORS' DUTIES

At the outset of Part II of this chapter, it was suggested that to simply state that the duty of a director was to act bona fide in the best interests of the company, was at best an illusive statement of a director's role in serving his or her company. It was suggested that one question a director would likely want to determine, especially when considering how to respond to an unsolicited takeover bid, was, what properly constitutes "the company". That is, to whom are directors' duties and obligations owed? Michael St. Patrick Baxter was of the opinion that it is of some import to determine to whom directors owe their fiduciary obligations, arguing that if the board of directors' fiduciary duties are owed to the company, or even primarily to the company, then the propriety of any action taken by the directors in the context of responding to an unsolicited takeover bid would be judged by the effects such action had on the welfare of the corporate entity far more than the peripheral effects that may be incurred by the shareholders. If on the other hand, shareholders' welfare was the primary concern of the directors then just the opposite would result; the conduct of the directors in how they responded to an unsolicited takeover bid

would be judged on how it affected the immediate interests of the shareholders and far less concern would be paid with respect of the corporate entity and its welfare. ¹⁷⁴

It has been suggested in this chapter, that the proper interpretation of the requirement that directors act bona fide in the best interests of the company, is that at law directors owe their duties to the corporate entity, which has been generally interpreted to mean the shareholders of the company as a whole.

Professor Welling however, has advised that the question to whom do directors owe their obligations, is a matter better left unasked. Professor Welling argues that, "[t]his question has been inconsistently dealt with in the English-based jurisprudence copied in Canada over the past 100 years." ¹⁷⁵

Professor Welling is of the opinion that under the present statutory regime set-up to govern corporate affairs in Canada, the issue of to whom directors owe their obligations to has become a moot point. ¹⁷⁶

Despite Professor Welling's counsel, the fact of the

¹⁷⁴ St Patrick Baxter, supra, note, 33 at 69.

¹⁷⁵ Supra, note 42 at 300.

¹⁷⁶ Ibid.

matter is that other academics are discussing this issue when considering what is the appropriate role of a board of directors in responding to an unsolicited takeover bid. As such, this issue cannot and should not as a matter of policy, be ignored completely.

J. C. Shepherd, and Michael St. Patrick Baxter are two examples of academics who have ventured to examine the appropriate role of directors in responding to an unsolicited takeover bid, and the question of to whom directors' obligations are owed.

J. C. Shepherd validly makes the point that when directors decide to issue shares in their company, they must exercise such power bona fide in the interests of the company.¹⁷⁷

Mr. Shepherd also advances by way of case law illustration, that there are two prevailing yet opposing theories in law in respect to this issue: One being that directors can never issue shares in the company for the purpose of affecting control, the other being, that directors can issue shares even if the purpose is to affect control,¹⁷⁸ if such conduct

¹⁷⁷ Supra, note, 78 at 363.

¹⁷⁸ In light of the rather tentative Canadian jurisprudence in respect to this issue, and in light of the Berger J.'s judgment in Teck, supra, note, 53, it may be more apt to say that directors may issue shares even if control is affected, so long as the primary purpose of the directors was to advance the best interests of the company.

would be in the best interests of the company.¹⁷⁹ On this basis J. C. Shepherd proposes that, "...the two positions reflects the doubt as to whether the directors' duty is solely to the corporation, or is to the shareholders as well."¹⁸⁰ With respect, the cases cited by Mr. Shepherd do not necessarily stand for the proposition he has advanced, that is, that the courts perceive that directors either owe their duties solely to the corporation, or to both the company and its shareholders. Arguably, the cases cited are simply illustrative of two opposing judicial views concerned with a number of inter-related company law matter, primarily with respect to a shareholders' proprietary rights and power within a company, as well as the vesting of, and perceived limits to, the board of directors' powers to manage a company under the "proper purpose doctrine". In all the cases advanced by Mr. Shepherd, the underlying premise for the decisions reached may more aptly be described as serving judicial policy predilection rather than, as Mr. Shepherd proposes, a reflection of doubts by the courts as to whether directors duty is owed solely to the company or also to its shareholders.

Briefly, those cases cited by Mr. Shepherd which he believes demonstrates that directors' obligations are owed to

¹⁷⁹ Supra, note, 78 at 363.

¹⁸⁰ Ibid.

the shareholders as well as to the company, being: Martin v. Gibson,¹⁸¹ Bonisteel v. Collis Leather,¹⁸² Hogg v. Cramphorn Ltd.,¹⁸³ and Bernard v. Valentini¹⁸⁴, may be alternatively interpreted, and which was briefly discussed above, to be illustrative of an Anglo-Canadian judicial tradition which tried to confine directors' powers to a perceived proper purpose for which the power was so conferred and beyond which the directors could not go. The cases proffered by Mr. Shepherd to support the proposition that the directors owe their duties solely to the company, were: Teck Corp. Ltd. v. Millar,¹⁸⁵ Bamford v. Bamford,¹⁸⁶ Savoy Corp. Ltd. v. Development Underwriting Ltd.,¹⁸⁷ Kors v. Carey,¹⁸⁸ and Cheff v. Mathes¹⁸⁹. It may in the alternative be said that these cases can be seen to be illustrative of an emerging judicial approach, (at least in Canada, Australia and in the United States) that requires that directors endeavour at all times to promote the interests of the company, which is

¹⁸¹ Supra, note 123.

¹⁸² (1917) O.L.R. 195.

¹⁸³ Supra, note 73.

¹⁸⁴ (1978), 18 O.R. (2d) 656 (Ont. H.C.).

¹⁸⁵ Supra, note 53.

¹⁸⁶ Supra, note 126.

¹⁸⁷ [1963] N.S.W.R. 138 (S.C.N.S.W.).

¹⁸⁸ (1960), 158 A. 2d 136.

¹⁸⁹ (1964) 199 A. 2d 548.

understood to mean the interests of the shareholders as a whole. As such, directors may in the bona fide execution of their duties, take whatever steps that are reasonably necessary to prevent perceived threats to the company's interests from occurring.

Michael St. Patrick Baxter, in his article, "The Fiduciary Obligations Of Directors Of A Target Company In Resisting An Unsolicited Takeover Bid",¹⁹⁰ goes on and broaches the topic of directors owing a bifurcated fiduciary obligation.¹⁹¹ Under this theory Michael St. Patrick Baxter's argues that directors owe a fiduciary duty to the company and **separately**, as well as **simultaneously**, to the company's shareholders.¹⁹² It is Mr. St Patrick Baxter's contention that by requiring directors to consider the interests of the company, while at the same time requiring them to consider the interests of the shareholders, sets up a duality of fiduciary duties which, if ever a company was to become subject to an unsolicited takeover bid, would be bound

¹⁹⁰ Supra, note 33.

¹⁹¹ Ibid. at 66.

¹⁹² See also Dodd, supra, note 37 at 1147 & note 6, where it states, "[t]hat many of their powers, such as the power of declaring or passing dividends and the power of issuing new stock, may affect the individual interests of the stockholders rather than the corporate enterprise as a whole is obvious and has led to a growing tendency to treat directors as fiduciaries for stockholders as well as for the corporate entity."

to conflict. This conflict of interests, consequently places the target directors in a very precarious, if not impossible position, of trying to honour opposing fiduciary obligations.¹⁹³

It is Mr. St. Patrick Baxter's contention that this concept of directors owing a bifurcated duty to the company and shareholders, is an emerging trend within the Canadian judiciary.¹⁹⁴ Citing for support of his proposition St. Patrick Baxter refers to the cases of Olympia & York Enterprises Ltd. v. Hiram Walker Resources Ltd.¹⁹⁵ and, First City Financial Corp. Ltd. v. Genstar Corp.¹⁹⁶

In Olympia & York Enterprises Ltd. v. Hiram Walker Resources Ltd., Montgomery J. found that the target board of directors acting on the sound advice of their financial advisors, and on the realization that the takeover offer did not adequately represent the true and intrinsic value of the shares being sought in the takeover bid, were correct in taking the steps they did to thwart the bid. Montgomery J.

¹⁹³ Supra, note 33 at 71.

¹⁹⁴ Ibid, at 71: "It appears that Canadian courts have recently moved towards acceptance of the proposition that directors owe a fiduciary duty to the shareholders as well as to the corporation."

¹⁹⁵ Supra, note, 96.

¹⁹⁶ (1981), 33 O.R. (2d) 631, 125 D.L.R. (3d) 303 (H.C.J.).

stated that directors would have been in breach of the duty to the shareholders otherwise.¹⁹⁷ In this case, it is difficult to see how Mr. St. Patrick Baxter extrapolates that the Court was necessarily advocating that the directors of Hiram Walker owed a bifurcated fiduciary duty, more than that the court was simply referring to the directors' "duty to the shareholders" as one and the same thing as the directors' duty to the company.

In First City Financial Corp. v. Genstar Corp. we see a somewhat stronger reference to directors' duties being owed to the company as well as separately to the shareholders. Reid J. stated in this case that, "[t]he right and indeed the obligation of directors to take steps that they honestly and reasonably believe are in the interests of the company and its shareholders in a take-over contest or in respect of a take-over bid, is perfectly clear and unchallenged."¹⁹⁸

However, what is not so clear is whether Reid J., (in making this statement during the course of his judgment denying an application for an interlocutory injunction on the basis that the subject matter at bar was better left for the expertise of the Ontario Securities Commission) was merely referring to the shareholders and the company as analogous, or

¹⁹⁷ Supra, note 96 at 210.

¹⁹⁸ Supra, note 196 at 646.

as Mr. St. Patrick Baxter suggests, that the judge was trying to establish that there existed a duty to both the shareholders and the company. It is relevant to note that Reid J. refers with approval to Teck Corporation Ltd. v. Millar¹⁹⁹, a judgment which tends not to support St. Patrick Baxter's theory.²⁰⁰

Like Olympia & York and First City Financial Corp., there are other cases in which the decisions rendered could be construed to support a bifurcated theory as proposed by St. Patrick Baxter. Take for example the case of Goldhar v. Quebec Manitou Mines Ltd.²⁰¹ particularly Reid J.'s comments that, "[i]ts [s. 122 (1) of the C.B.C.A., R.S.C. 1985, c. C-44] is a broad statement of obligations of directors. Its underlying concept is not new; the obligations owed by directors to corporations, and through them to shareholders...".²⁰² Alternatively, in Farnham v. Fingold, Morand J. commented, in determining whether a group of minority shareholders could, under the rules of civil procedure in Ontario, bring a class action suit against the majority shareholders, that there was a "general duty" owed to

¹⁹⁹ Ibid.

²⁰⁰ Berger J., in Teck, makes no reference to their being a separate duty owed by the directors to the company and to the company's shareholders.

²⁰¹ (1976), 61 D.L.R. (3d) 612.

²⁰² Ibid. at 614.

the shareholders by the directors.²⁰³ In the Australian case of Richard Brady Franks Ltd. v. Price, Dixon J. stated that, "[i]n considering such a question, it is important to ascertain what are the purposes for which powers are given and to remember that the fiduciary duty of the directors is to the company and the shareholders."²⁰⁴ In Goldex Mines Ltd. v. Revill,²⁰⁵ the court discusses in part, Stanley M. Beck's article, "The Shareholders' Derivative Action", stating that:

To cause the company to act to serve personal objectives of the directors would clearly be a breach of the directors' fiduciary duty to the company. Beck suggests that it is also a breach of the directors' fiduciary duty to shareholders as a whole - the duty 'to act with an even hand and in good faith'; he also asserts that this principle has been indicated (if not always clearly expressed) in the decided cases.²⁰⁶

Finally, in Exco v. Nova Scotia Savings & Loan, Richard J. described the actions of the directors in resisting a takeover bid as being motivated more by self-interest than by company interest and in so doing the directors breached their fiduciary duty to the general shareholders.²⁰⁷

²⁰³ Supra, note 77 at 696.

²⁰⁴ (1937) 58 C.L.R. 112 at 143.

²⁰⁵ (1975), 54 D.L.R. 672 at 677-78.

²⁰⁶ 52 Can. Bar Rev. 159 (1974) at 185-86.

²⁰⁷ Supra, note 97 at ?.

Although these cases may be amenable to an interpretation that there exists a growing acceptance that as a matter of law directors owe their fiduciary duties to the company and its shareholders, an alternative interpretation may simply be that the fine legal distinction between "the company" and "the shareholders" can in the course of a judgment become somewhat blurred, or is in fact perceived as not being relevant to the justiciability or fairness of a decision reached in the particular case.

St. Patrick Baxter presents two intriguing but arguably flawed theoretical propositions as to what should be the appropriate role of a target director in responding to an unsolicited takeover bid. The first proposition is premised on notions of what constitutes "a company". Mr. St. Patrick Baxter argues, (and I would say correctly) that a company is best interpreted to mean a composite of two primary factors; one being the commercial entity side of the company that is separate and apart from the shareholders, and the second being the shareholders of the company themselves. However Mr. St. Patrick Baxter's maintains that the "commercial side" of a company has a valid interest to exist as an entity separate and apart from the interests of the shareholders. As such, the board of directors of a company that has become the subject of an unsolicited takeover bid has a duty to consider the company's interests to continue its commercial existence

unmolested, even where a takeover bid would otherwise be in the interest of the shareholders as a whole. By necessary implication, a takeover bid could be properly defended by target directors in the execution of the fiduciary duties if the threat to the company's continual existence would warrant such an undertaking despite the better interests of the shareholders. This is the potential conflict of interest that Michael St. Patrick Baxter refers to, and is the premise for his bifurcated duty theory.

St. Patrick Baxter suggests that to equate the interests of the company to mean the interests of the shareholders as a whole,²⁰⁸ is simply a way for the judiciary to "sidestep" the real issue of conflicting interests amongst the various constituencies that make-up "the company"²⁰⁹

The probity of equating the interests of the company to mean the interests of the shareholders as a whole is rejected by Mr. St. Patrick Baxter, as he argues, the chances of the shareholders ever having a common interest in the context of an unsolicited takeover bid is highly improbable, and even in the unlikely event that the shareholders have a common interest, what may be in the interests of the shareholders as

²⁰⁸ Supra, note 33 at 71-72, referring to the judgement of Boyd C. in, Martin v. Gibson, supra, note 160.

²⁰⁹ Supra, note 33 at 71-72.

a whole, may not necessarily be in the interests of the company.²¹⁰

St. Patrick Baxter's first point is well made. He questions whether it is possible for there ever to be an interest that can validly be said to be commonly shared amongst all the shareholders.²¹¹ With respect to his latter point however, the premise for this is tenuous in law and in theory. Although it is not clear whether St. Patrick Baxter is referring to interests generally associated with the so-called "long-term" or the "short-term" shareholders,²¹² it would seem that in any event, the outcome would be no different. The interests of the shareholders as a whole, even if those interests were to be properly characterized as those typically associated with long-term shareholders, are according to Mr. St. Patrick Baxter's analysis, subject to being subsumed to those interests of the company. This begs

²¹⁰ Ibid.

²¹¹ This issues will be discussed in more detail below.

²¹² In corporate control situations like that of a hostile takeover bid, shareholders' interests tends to fall within two opposing camps: One group of shareholders will want to tender their shares at the price being offered. The other group of shareholders will not want to tender their shares, having determined that their best interests will be better served if the bid is thwarted. The former group of shareholders are traditionally referred to as the "short-term" shareholders, the latter group, the long-term" shareholders. It is said that the interests of the company are usually aligned with those of the long-term shareholders. This topic will be addressed below in more detail.

the question, what are the interests of a company if they are not those of the long-term shareholders?

A. A. Sommer is of the opinion that the interests of the company and those of the shareholders, at least the long-term shareholders, are one and the same. According to Sommer's position, Mr. St. Patrick Baxter would have to, in trying to define the interests of the company, come up with a definition that in substance is materially different from simply restating what are typically associated with the long-term interests of the shareholders. ²¹³

Sommer makes an interesting observation when he suggest that if a corporation's interests were not seen as the embodiment of the interests of the shareholders then the present development of other constituencies legislation in the United States would be redundant. ²¹⁴ Sommer argues that if a corporation were in deed considered to have separate

²¹³ Supra, note 55 at 47.

²¹⁴ Other constituencies are basically various non-shareholder interests that do not fall as of right, within the "corporate sphere" of concerns, (i.e. the maximizing profit for shareholder gain) but nonetheless may be affected by corporate behaviour. Other constituency legislation can be described as an attempt to recognize the legitimacy of directors considering, or being required to consider, these other constituency interests when determining company objectives and policies. Other constituents are for example a company's shareholders, its customers, the community in which the company operates out of, national concern such as the economy or patriotism.

interests from its shareholders than by necessary implication it could consider a wide range of factors not necessarily connected to the interests of shareholders, in its attempt to continue to exist. Mr. Sommer's point is that there would be no need to legislate or even consider other constituency laws.

Professor Gower, in his commentary of Mr Holland's report, The Savoy Hotel Limited And The Berkeley Hotel Company Ltd., stated:

It is true that here and elsewhere Mr. Holland appears to draw a distinction between the company and its members, but unless one is a fierce partisan of the realist theory of corporate personality it is difficult to see how this distinction can be drawn unless the interests of human beings other than the stockholders can be considered. Having ruled out employees it seems unlikely that Mr. Holland would have admitted customers or, a fortiori, management, and if these are excluded, what remains? 215(a)

Charles R. Spector pointedly discusses the argument that technically, because Canadian corporate statutes explicitly state that the fiduciary duty of directors is owed to the company and not expressly to its shareholders, that directors could conceivably "consider factors other than the maximization of shareholder value in evaluating and developing strategy in defending against a hostile takeover, this view

was not accepted in the recent Olympia York case."²¹⁵

With respect to directors owing a fiduciary duty to the shareholders, Lord Cullen in Dawson Int'l v. Coats Plc. & Ors stated that:

I think it is important to emphasise that what I am being asked to consider is the alleged fiduciary duty of directors to current shareholders as sellers of their shares. This must not be confused with their duty to consider the interests of shareholders in the discharge of their duty to the company. What is in the interests of current shareholders as sellers of their shares may not necessarily coincide with what is in the interests of the company. The creation of parallel duties could lead to conflict. Directors have but one master, the company.

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In an attempt to re-enforce his argument of the emergence of a bifurcated theory of director's duties and obligations, Michael St. Patrick Baxter refers²¹⁷ to the following

215(a) "Corporate Control: The Battle For The Berkeley", supra, note 55 at 1189.

²¹⁵ Spector, supra, note 11 at 150.

²¹⁶ (1988) 4 B.C.C. 305 at 313, see Farrar, supra, note 1 at 2, 30-31.

²¹⁷ Supra, note 33 at 71 & note 44.

statement made by J. C. Shepherd, from that author's text, The Law of Fiduciaries, "[w]hat is clear is that Anglo-Canadian jurisprudence is rapidly following the path trod by the United States courts on this issue and, if it is still arguable that the directors are not the shareholders' fiduciaries, the trend is decidedly against that argument." ²¹⁸

It is debatable whether this statement accurately reflects authority for the proposition advocated by St. Patrick Baxter that directors owe separate fiduciary obligations to the company and the shareholders.

Mr Shepherd limited his discussion of a potential situation in which directors could owe dual fiduciary obligations to the company and to its shareholders, to circumstances where the director knowingly entered into a special relationship with a certain shareholder, or group of shareholders. Shepherd uses the example of a group or class of shareholders who, with the concurrence of the nominee director, use their combined influence to elect the nominee to the board of directors. Mr. Shepherd theorizes that under a

²¹⁸ Supra, note 78. See also Dodd, supra, note 37 at 1146-47 & note 6, where Dodd states, "[t]hat directors are fiduciaries for their corporations is indisputable. That many of their powers, such as the power of declaring or passing dividends and the power of issuing new stock, may affect the individual interests of the stockholders rather than the corporate enterprise as a whole is obvious and has led to a growing tendency to treat directors as fiduciaries for stockholders as well as for the corporate entity."

scenario like this, a director may be subject to conflicting fiduciary obligations to the company and to that group of shareholders who had arranged for his or her election. Shepherd argued that these shareholders might well expect that their particular interests will be represented by that director. The possibility of conflict arises if at some point the interests of the company, which all directors are sworn to serve, and the particular interests of that group of shareholders who elected the director are different. ²¹⁹

J. C. Shepherd does discuss the existence of a general fiduciary obligation of directors to the shareholders, but only in very broad terms, and prefaces his remarks with the caveat that such a concept was based in theory only, stating, "[a]gain limiting ourselves here to theory, there is a fiduciary relationship created between directors and shareholders based on a conditional transfer of powers." ²²⁰ Shepherd theorizes that, based on what he calls "an indirect and conditional transfer of powers" from the shareholders to the directors, directors would owe a general fiduciary obligation to the shareholders. Shepherd argues that "the power" which originated in the shareholders, is transferred indirectly to a director upon their election to office. ²²¹

²¹⁹ Supra, note 78 at 352-53.

²²⁰ Ibid. at 353.

²²¹ Ibid. at 352.

This "transfer of power" is conditional because after the shareholders elect their directors they, "...will naturally expect that, in the exercise of these powers, the directors, as well as considering the interests of the corporation, will also direct their minds to the interests of the shareholders."

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The notion that the directors' power to manage the business and affairs of the company are somehow "transferred" to the directors from the shareholders, as the basis for establishing the existence of a general fiduciary relationship is somewhat curious, especially in those jurisdictions where directors derive authority to manage the business and affairs of the company through statutory mandate. Under such conditions it is difficult to see how one can read into the legislation that this authority on the part of the directors to manage the company is somehow initially belonging to the shareholders, who later on "indirectly" vested it in the directors. 223(a)

J. C. Shepherd does, in discussing the case of Percival v. Wright,²²³ state that this case has been replaced in most

²²² Ibid. at 353.

²²³(a) See Welling, supra, note 42 at 338-39 & note 125, 343-44 & note 142.

²²³ Supra, note 141.

of the United States with a rule making directors fiduciaries of the shareholders. ²²⁴ However, again it is not clear that Mr. Shepherd is saying that in the United States directors legally and generally owe **separate** fiduciary duties to the shareholders as well as to the company. Nor could it be said that the cases Shepherd referred to on this point must be taken to support such a conclusion. It is arguable that strict rule of law in Percival v. Wright which Shepherd speaks of as being replaced in the U.S., is in fact being replaced not by a judicial doctrine that interprets the interests of company and shareholder as separate, but rather, that the interests of the company is properly understood to mean the shareholders as a whole, and vice versa.

Shepherd refers in part, to the cases of Schaffhauser v. Arnholt & Schaefer Brewing ²²⁵, Weisbecker v. Hosiery Patents, Inc. et al, ²²⁶ and Selheimer v. Manganese Corp. of America. ²²⁷

In Schaffhauser v. Arnholt & Schaefer Brewing, the president of Schaefer Brewing company, who was also one of the

²²⁴ Supra, note 78 at 355-56. See also Gower, supra, note 45 at 573.

²²⁵ (1907) 67 A. 417.

²²⁶ (1947) 51 A. 2d 811.

²²⁷ (1967) 224 A. 2d 634.

company's five directors, managed through his influence over two other directors, to get a motion passed at a meeting of the board of directors giving himself as president, a 50% increase in salary. The two remaining directors who were also shareholders, voted against the motion, and challenged the salary increase in court. On appeal, the court held that though one could not in law say that a director was a trustee for shareholders that, "...there can be no doubt he does occupy such a fiduciary relation as to imperatively demand, both in good morals and sound law, that he shall manage the business of the company in such a manner as to promote, not his own interests, but the common interests of all the shareholder ." ²²⁸ The court in Selheimer v. Manganese Corp. of America, came to the same conclusion in determining the outcome of a shareholders' derivative suit, in which the directors had caused the bankruptcy of their company due to their gross incompetence. ²²⁹ In Weisbecker v. Hosiery Patents, Inc., the court, after a thorough review of the law as it relates to majority shareholders' obligations to minority shareholders, found that the majority shareholders of the company at the case at bar, took steps in dissolving the company that were technically in law legal, but in equity were solely used as a device to commit fraud against a minority

²²⁸ Supra, note 225 at 417.

²²⁹ Supra, note 227 at 642.

shareholder.²³⁰

In all these cases, the judgments seem to suggest that the courts were interpreting the duties of the directors being at law owed to the company, but were in fact better understood as being owed to the shareholders as a whole, and as such the directors must act in utmost good faith when dealing with their shareholders.

It has been proposed that what is occurring in the United States is that the courts there have simply blurred the meaning between company and shareholders. That reference to either, "the company", or "the shareholders" is not meant to convey distinction between the two that would support, as Mr. St. Patrick Baxter would suggest, the notion that directors owe a bifurcated fiduciary duty. Rather, reference to one automatically subsumes the other. That is, each are analogous terms. A. A. Sommer clearly advocates that the prevailing understanding of the meaning of the interests of the "corporation" is synonymous with the concept of the interests of the "shareholders as a whole". Sommer states that, "[i]n the United states the equivalence of "corporation" and "shareholders" (or at least the long-term interests of shareholders) is most clearly seen in the manner in which courts and writers have used these terms, and that usage tends

²³⁰ Supra, note 226 at 816-17.

to show that they use them as equivalents.²³¹ Sommer illustrates his argument with reference to the case of Unocal Corp. v. Mesa Petroleum Co.²³², in which case Sommer cites that the court, "...in the course of two pages, described the directors' fundamental duty and obligations' as running to "the corporate enterprise, which includes stockholders", later to "the corporation and its shareholders", and finally, to just "the corporation's stockholders."

It was summed up in John L. Warden's article, "The Boardroom as a War Room: The Real World Application of the Duty of Care and the Duty of Loyalty", that the consensus in the U.S. is that the directors' obligations are to the shareholders as a whole, mirroring the obligations the directors have to the company.²³³

In concluding his article, St. Patrick Baxter felt that notwithstanding the various conceptual difficulties, the bifurcated approach as he suggested was the correct approach to take, however, Mr. St. Parick Baxter left as an open question, how in law this would be established.²³⁴

²³¹ Supra, note 55 at 48.

²³² 493 A 2d 946 (Del. 1985).

²³³ (1985) 40 Bus. Lawyer 143.

²³⁴ Supra, note 33 at 72 & note 49.

St. Patrick Baxter's second proposition advocates that directors should, as a general rule, owe a fiduciary duty to each shareholder individually. He states that:

It has also been asserted in support of the bifurcated duty that 'the interests which should be weighed against those of the company are those of the shareholders collectively and not the individual interests of any one or more shareholders.' This argument has immediate appeal. To be sure, shareholders have common interests (for example, the financial success of the corporation) and their common interests usually tend to align with the interests of the corporation. In this regard a separate duty to the shareholders may well be duplicative of the duty to the corporation. But shareholders also have different interests and this is dramatized in the context of an unsolicited takeover bid. Surely a director, as a fiduciary, must consider those interest that are not in common. To do otherwise would not be consistent with the duty of a fiduciary to treat beneficiaries of the same class equally.²³⁵

Arguably, such an interpretation of directors' duties seeks to extend fiduciary obligations beyond reasonable limits. Strictly from a practically preceptive (disregarding for the moment how in law this duty would be established), such a proposition would be logistically impractical to put into effect save for small, closely held companies. Directors of companies with a large number of registered shareholders could not possibly canvass, let alone reconcile, the inevitable sundry of their shareholders' concerns and interests. Apparently St. Patrick Baxter has uncritically

²³⁵ Ibid. at 72.

accepted fundamental principles of trust law, and projected those exacting standards of behaviour onto company directors. Company directors are often referred to as trustees, however directors are anything but trustees in the true sense of the word. In the execution of their management role directors are in many ways the antithesis of trustees, the latter are appointed to preserve property, while the former are appointed to risk the loss of property and resources with a view to earning a profit.²³⁶

This proposition that directors should owe a fiduciary obligations to the shareholders individually is not generally supported within the legal community. On the contrary, such a finding would be an exception to the norm. As was discussed above, Professor Gower points out that the fiduciary duties of the directors are owed to the company and to the company alone.²³⁷ In Palmer's Company Law, it is stated that, "[t]he fiduciary relationship of a director exists with the company: the director is not usually a trustee for individual shareholders."²³⁸ Finally, Christopher L. Ryan, argued that, "[t]he directors duties are owed collectively to the

²³⁶ See J. L. Howard, "Fiduciary Obligations" supra, note 58 at 3.1.06; Berle, supra, note 37 at 1074.

²³⁷ Supra, note 169 at 573.

²³⁸ Supra, note 169 at 8101.

company's members rather than the individual member." ²³⁷

It may be suggested that to establish a fiduciary duty between a shareholder individually and a director certain fundamental requirements need to exist, such as:

(1) a transfer of authority from the shareholder to the director, to act on the behalf of the shareholder, ²⁴⁰

(2) a corresponding acceptance by the director of this authority and from which authority arises an opportunity to affect the interests of the shareholder, and

(3) a corresponding vulnerability on the part of the shareholder because of the authority transfer to the director.

John L. Howard suggested that, "[a]lthough there have been some judges who appear to prefer to treat every fiduciary as an analogue of a trustee...the evolving case law, ...has produced a non-contractual, reliance doctrine...a fiduciary duty ... might be found to exist in any circumstance where a

²³⁹ Company Directors Liabilities, Rights and Duties 2d ed. (Oxfordshire: CCH Ed. Ltd., 1987).

²⁴⁰ However it does not necessarily follow that absent any overt or explicit transfer of authority from a shareholder to a director to act on his or her behalf would be a bar to establishing on the facts that a fiduciary relationship did exist.

principal delegates authority to a fiduciary and justifiably relies on that fiduciary to represent his interests in a completely unbiased manner".²⁴¹ J. C. Shepherd also advanced a similar notion in presenting a theory which encompassed shareholders and directors stating that:

We have presented a theory that a fiduciary relationship is created whenever one person transfers power to another on a condition, known to the transferee, that the powers be used for the benefit of the transferor or his nominee. Such powers may be legal or practical, they may result from a conscious or de facto transfer, and they may be affixed with a duty either expressly or by implication.²⁴²

In referring to Gibbs C. J.'s decision in Hospital Products Ltd. v. United States Surgical Corporation,²⁴³ Craig Orr probably best illustrated the basic requisite elements required to determining a fiduciary, stating:

B owes a fiduciary duty to A if: (1) B has been entrusted with the power to affect A's interests in a legal or practical sense, so that A is in a position of vulnerability; and (2) B has undertaken to act in relation to a particular matter in the interests of A, or of A and B jointly, and not solely in his own interests.²⁴⁴

²⁴¹ "Fiduciary Obligations", supra, note 58 at 3.1.07.

²⁴² Supra, note 78 at 351-52.

²⁴³ (1984) 58 A.L.J.R. 587 (H.C.A.) at 596-97.

²⁴⁴ Part I, supra, note 75 at C-3.

Generally, these requisite elements that are necessary for establishing an individual fiduciary obligation between a shareholder and a director are not part of the typical shareholder - director relationship. This is especially so in companies with a large number of shareholders. In the context of an unsolicited takeover bid, although some target shareholders may feel vulnerable that their directors may deny them the opportunity to tender their shares to the offeror, where directors are statutorily empowered to manage the business and affairs of a company there is, as a general rule, no "transferring of authority" by shareholders to the directors to act on their individual behalf.

It has also been advanced that, "[i]n order to found a fiduciary obligation, the nature of the situation must be such that the party who is implicitly dependent is required to be so because his legal remedies are insufficient."²⁴⁵ Based on this test, one could argue that target shareholders would not generally be classified as being owed fiduciary obligations by the directors because as shareholders they have available to them sufficient statutory protection from, and recourse to, errant directors for alleged breaches of their obligations when responding to an unsolicited takeover bid.

²⁴⁵ D. S. K. Ong, "Fiduciaries: Identification and Remedies" (1986) 8 U. of Tasmania L. Rev. 310, as cited in S. A. Romano, "Fiduciary Duties After Lac. v. Corona" (1990) 4 Can. Corp. L. Reporter C 135 at C 142.

This point is well made, when one thinks that shareholders' derivative rights are in fact derived from the obligations owed to the company by the directors.²⁴⁶

Finally, it can be said that there are no fiduciary duties owe by directors to the shareholders generally, because such is not the expectation of the shareholder. A shareholder does not anticipate that he or she will be receiving individual representation from their directors in the day-to-day management of the company, nor would a shareholder expect such treatment in those extraordinary corporate events such as when an unsolicited takeover bid is announced.²⁴⁷

It cannot, however, be dismissed out of hand that directors can never owe a fiduciary obligation to their shareholders individually. There are times where, usually because of the particular special relationship and/or circumstances that exists between director(s) and shareholder(s), that a court may deem that fiduciary obligation between the two parties has properly been established. "[The courts have]...extended the fiduciary concept to relationships that did not fit into any preconceived technical or legal category, depending on the

²⁴⁶ See Re Goldhar v. Quebec Manitou Mines Ltd., supra, note 201 at 616-17.

²⁴⁷ The notion of shareholders' expectations will be addressed in greater detail below.

extent to which a beneficiary places trust in, and, as a corollary, justifiably relied on the honesty, integrity, and fairness of the fiduciary. Thus a fiduciary duty may be found to exist even though it might not be superficially inferred from the legal or technical relationship between the parties."²⁴⁸ A relationship sufficient in its nature to establish fiduciary duties between a director and a shareholder(s), is likely to be found in closely held companies. It is in these types of companies where often can exist special intimacy between the two parties having many of the earmarks for the creation of fiduciary obligations.²⁴⁹

Courts have been willing to impose a fiduciary obligation on directors whose course of conduct vis-a-vis the shareholders would so warrant such a finding. Take for example, Allen v. Hyatt,²⁵⁰ a case eventually determined in the Privy Council. In Allen v. Hyatt the directors of an Ontario company called Lakeside Canning Co. Ltd., were negotiating the sale of the business to an amalgamated company called, The Dominion Cannery Ltd. The directors told their shareholders that in order to negotiate effectively with The

²⁴⁸ J. L. Howard, "Fiduciary Obligations" supra, note 58 at 3.1.02.

²⁴⁹ A closed corporation is one typically owned and managed by a small number of shareholders. The shares are restricted, and often the shareholders depend on the remunerations received through employment in the company.

²⁵⁰ (1914) 17 D.L.R. 7 (P.C.).

Dominion Cannery Ltd. they required the consent of the majority of the shareholders. On this basis the directors somehow managed to induce a number of shareholders to give them an option on their shares. The directors had basically lied to the shareholders. After the deal with The Dominion Cannery went through, the directors exercised the options, sold the shares and kept the profits for themselves. There were certain issues of procedure and proper standing addressed throughout the various appeals, however the basic finding of the courts was that though in law the directors owe a fiduciary duty to the company and not the shareholders, when directors hold themselves out to the shareholders in the regard that they will be acting on their behalf, they become the agents of the shareholders and as such owe the shareholders a fiduciary duty. Lord Haldane stated that:

The appellants [the defendant directors at trial] appear to have been under the impression that the directors of a company are entitled under all circumstances to act as though they owed no duty to individual shareholders. No doubt the duty of the directors is primarily one to the company itself. ...the directors must here be taken to have held themselves out to the individual shareholders as acting for them on the same footing as they were acting for the company itself, that is as agents.

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The court in Allen v. Hyatt distinguished Percival v. Wright on the basis that the directors of the Lakeside Canning

²⁵¹ Ibid. at 11-12.

Company had gone out of their way to solicit the trust of their shareholders and had held themselves out to the shareholders that they were going to act on their behalf, also in Percival v. Wright there was no finding the directors had acted in any way improperly or mala fide.

Gadsden v. Bennetto (No.2) is another case where the courts have extended fiduciary obligations from the directors to the shareholders. This is a straight forward case of the directors committing fraud against a shareholder. The directors had arranged the sale of the company's principle asset, (a piece of land) for a sizable profit. The directors then induced the plaintiff-shareholder to sell his two shares to them without disclosing that the property had been sold, and without disclosing that as a consequence of the sale his shares in the company were worth significantly more. The Court of Appeal reversing the trial decision, did not think that Percival v. Wright was applicable in this case because of flagrant fraud committed by the directors; the Court cited Allen v. Hyatt to support their position. Perdue J., also attempted to mould a fiduciary duty on the basis that the directors had acted extraordinarily in their role as members of a "special sale committee" to seek out a purchaser for the company's property and create a sale which included the disposition of the shareholders' shares because once the land (the only asset of the company) was sold, their shares would

be worthless. Therefore, Perdue J. contended that the shareholders had a legitimate and immediate interest with respect to the terms of any proposed sale of the property, and the directors of the "special committee" owed both the company and the shareholders a fiduciary duty to disclose all relevant information in respect of the sale. ²⁵²

In the case of Coleman v. Myers. ²⁵³ the directors of a family run business were held to be in breach of their fiduciary duties to the shareholders (not to mention being found guilty of fraud). In this case the directors used insider information of a pending takeover bid for their company to take advantage of the shareholders, who were also consanguineously related. The directors were found to be in breach of their fiduciary duties in recommending that the shareholders accept the takeover bid at a price they knew was not reflective of the company's true value. What is important to note about this case is that at trial, Mahon J. was unable to distinguish on the facts Percival v. Wright, or to find helpful the decision reached in Allen v. Hyatt. ²⁵⁴ Mahon J. therefore, declined to follow Percival v. Wright as being good law, ²⁵⁵ and determined that there is an inherent

²⁵² (1913) 9 D.L.R. 719 at 720 (Man. C.A.).

²⁵³ Supra, note 140.

²⁵⁴ Ibid. at 274 & 273 respectfully.

²⁵⁵ Ibid. at 278.

fiduciary duty on the part of directors in negotiating the sale of a company to disclose to the shareholders all relevant information. ²⁵⁶ (However in the end, Mahon J. did find in favour of the defendant directors) The Court of Appeal did not see the necessity of jettisoning Percival v. Wright, and maintained that a director may owe a duty to the shareholders, but not as a general rule of law, but rather, depending on the special circumstances of any particular case. In the case at bar the familial nature of the relationship between the directors and the shareholders was sufficient to establish that the directors owed a fiduciary duty to the shareholders individually. ²⁵⁷

In Goldex Mines Ltd. v. Revill, ²⁵⁸ the court held that whether in accordance with prevailing statutory provisions or whether the director chose voluntarily, directors must in disseminating information to the shareholders act bona fide at all time. Brightman J. echoed similar sentiments in Gething v. Kilner, ²⁵⁹ saying, "...that the directors of an offeree company have a duty towards their own shareholders, which...clearly includes a duty to be honest and a duty not to

²⁵⁶ Ibid. at 278.

²⁵⁷ See the remarks of Woodhouse J. ibid. at 324-25. See also Gore-Browne On Companies, supra, note 146 at 27-8.

²⁵⁸ Supra, note 205 at 679.

²⁵⁹ [1972] 1 W.L.R. 337 at 341.

mislead". In Re A Company,²⁶⁰ Hoffmann J. expressed that directors will owe shareholders an obligation if not a fiduciary duty, where they give advice to the shareholders in respect to the merits of a takeover bid.

²⁶⁰ [1986] B.C.L.C. 382 at 389.

CHAPTER FIVE

WHAT ARE THE INTERESTS OF THE SHAREHOLDERS AS A WHOLE?
REASONABLE SHAREHOLDERS' EXPECTATIONS ESTABLISHING LEGITIMATE
SHAREHOLDERS' INTERESTS

If we accept that the directors' equitable obligations are to the shareholders as a whole, we are that much closer to understanding what the appropriate role of target directors may be in responding to an unsolicited takeover bid. That is, directors must determine what response (if any), would most likely succeed in advancing the interests of all the shareholders of the company. Once that has been determined, directors must implement that course of action reasonably necessary to bring this determined "interests of the shareholders" to fruition.

Is it not however, somewhat equivocal to simply state that the proper interpretation of the phrase, "the best interests of the company" means, "the best interest of the shareholders as a whole"? Are we not left searching for an interpretation of an interpretation? A. A. Sommer commented on this issue by querying:

If one accepts that when one speaks of the "best interests of the corporation" he or she in fact speaks of the best interests of its shareholders, the question then is how one identifies the best interests of the shareholders. Shareholders and their interests come in shapes and sizes as varied as their numbers...Accepting the equivalence of "corporate best interests" with "shareholder best interests " appears to simply substitute one quagmire for another.²⁶¹

What is this so-called best interest of the shareholders as a whole? Is there in fact some overall commonly shared interest amongst the shareholders capable of being identified and promoted by directors? If not, if there are a number of competing interests that are held by shareholders, how then are the directors of a company that has become the subject of an unsolicited takeover bid, to determine which of the various shareholders' interests or combinations thereof, reflects the best interests of the shareholders as a whole? Are the directors to somehow try and balance the competing shareholders' interests on some kind of sliding-like scale of relative importance, choosing to respond to the takeover bid so as to advance some overall interest that the directors determined to be the most meritorious, or the most fair? If so, on what basis do they decide questions of importance of interests?

Berger J. recognized the problem in his decision in Teck,

²⁶¹ Supra, note 55 at 50-51.

stating that:

The classical theory is that the directors' duty is to the company. The company's shareholders are the company...and therefore no interests outside those of the shareholders can legitimately be considered by the directors. But even accepting that, what comes within the definition of the interests of the shareholders? By what standards are the shareholders' interests to be measured? ²⁶²

Invariably shareholders will have their own interpretations as to what is, or is not, in their best interests, no doubt reflective of their own personal agenda and circumstances at any given time. When an unsolicited takeover bid is made for a company one might well expect that the idiosyncratic interests of the shareholders will become even more estranged. Be that as it may, it can be said that a typical concern, at least for a majority of shareholders who are being solicited to tender their shares under a takeover bid, is in respect of the "price" that is being offered in exchange for their shares. ²⁶³

A takeover bid will inevitably be made at a premium above the market price of the target shares. As discussed previously, this premium can be properly characterized as an

²⁶² Supra, note 53 at D.L.R. 313-14, W.W.R. 412.

²⁶³ The "price" typically being all cash, or part cash and part share exchange in the offeror's company.

attempt by the offeror to solicit the target shareholders into readily tendering their shares. As such, a takeover bid may appear to the shareholders in the target company as an unexpected windfall. Many shareholders can be expected to assess the adequacy of a takeover bid purely on a comparative basis of what they could receive for their shares under the bid, to that which they would otherwise likely be able to get in the current market place. Although a takeover bid made at a significant premium may appear to be in the interests of the shareholders, the offer may in fact be specious because it fails to adequately compensate the shareholders for the true and intrinsic value of their company. There may be a number of reasons not necessarily readily apparent to the target shareholders, why this may be so. Richard C. Brown discusses in his article, "The Role of the Courts in Hostile Takeovers" some of the reasons why a takeover bid may in fact not be in the best interests of the shareholders. Brown states:

That a [takeover]...offer price merely contains a substantial premium over market value, standing alone, does not provide an adequate basis upon which to assess the fairness of the offering price. The market may have undervalued a particular corporation's stock for a variety of reasons...For example, internal market dynamics, the vagaries of investors' perceptions, speculative prognostications by currently in vogue analysts, governmental policies, political developments, general purchasing trends and rumours - all play a role in market pricing and may render the current market value of a particular stock an unreliable yardstick for measuring the actual worth of the

business as a continuing commercial entity. ²⁶⁴

Richard Brown also makes the insightful observation that "...the market price of a publicly traded stock is solely a measure of the value of a minority position in that stock; whereas, a [takeover bid]... offer is made for a controlling position in the stock. Thus, the adequacy of a premium paid for control cannot be assessed solely in terms of its magnitude in relation to a market price that merely reflects the value of a single share." ²⁶⁵

It can be said that an inadequate takeover bid offer cannot be in the best interests of the targets of the shareholders as a whole because if it were to succeed, the intrinsic value of target company would accrue to the offeror rather than to the target shareholders. Regardless if a takeover bid is determined to be inadequate, there will inevitably be target shareholders who for whatever the particular circumstance, (or more precisely, because of their particular circumstances) are motivated to tender their shares at the price offered. Such shareholders desirous to tender their shares will perceive that their best interests will be served if the takeover bid goes through. These shareholders

²⁶⁴ Supra, note 24 at 212.

²⁶⁵ Ibid.

will not want their board of directors to take any overt steps to block or otherwise impede the successful conclusion of the bid. In contrast, there will likely be shareholders within the target company who perceive that their interests will be better served by retaining their shares. These shareholders will want the takeover bid (as offered) to be thwarted in some manner. The former type of shareholders are often referred to as "short-term shareholders", the latter are generally referred to as "long-term shareholders".²⁶⁶

In the context of an unsolicited takeover bid there is obviously some equivocation to the adage that "the best interests of the company" means "the best interests of the shareholders as a whole". If the best interests of shareholders is served by promoting shareholder value;²⁶⁷ is it maximizing the long-term or short-term shareholders' value that should be of proper concern of the target directors in determining how best to respond to an unsolicited takeover bid? If it can be said that the best interests of the company is better understood to mean the interests of the long-term shareholders, than on what basis is this so?

In the U.S. case of TW Services Inc., v. SWT Acquisitions Corp., Chancellor Allen, in reference to directors'

²⁶⁶ See supra, note 212.

²⁶⁷ See Stransman, supra, note 43 62.

obligations to promote the interests of their company and their shareholders stated:

The knowledgeable reader will recognize that this particular phrase [the board's duty to the corporation and its shareholders] masks the most fundamental issue: to what interest does the board look in resolving conflicts between interests in the corporation that may be characterized as "shareholder long[-]term interests" or "corporate entity interests" or "multi-constituency interests" on the one hand, and interests that may be characterized as "shareholder short[-]term interests" or "current share value interests" on the other? ²⁶⁸

Lamtham C.J., expressed in Mills v. Mills, that, "[t]he question which arises is sometimes not a question of the interests of the company at all, but a question of what is fair between different classes of shareholders. Where such a case arises some other test than that of the "interests of the company" must be applied..." ²⁶⁹

In the context of an unsolicited takeover bid, the so-called test of the "interests of the company" may not be as inadequate as Lamtham C.J. suggested. Arguably, the entire approach of discussing what may or may not be the appropriate role of target directors in responding to an unsolicited

²⁶⁸ Reprinted 14 Del. J. Corp. L. at 1182, as cited in Sommer, supra, note 55 at 49-50.

²⁶⁹ (1938) 60 C.L.R. 150 at 164. See also MacIntosh, "Minority Shareholders' Rights in Canada", supra, note 60 at 613.

takeover bid to promote the best interests of the company has been unnecessarily clouded by this notion of conflicting shareholders' interests, be it long-term versus short-term shareholders' interests, or any other interests held one shareholder, or group of shareholders, that are not correspondingly held by other shareholders. In the decision of the Supreme Court of Delaware in Paramount Communications, Inc. v. Time Inc., the Court addressed this issue stating:

[A board of directors]...mandate includes a conferred authority to set a corporate course of action, including time frame, designed to enhance corporate profitability. Thus, the question of "long-term" versus "short-term" values is largely irrelevant because directors, generally, are obliged to chart a course for a corporation which is in its best interests without regard to fixed investment horizon.²⁷⁰

It may be valid to say that at the time a company is confronted with an unsolicited takeover bid there are likely to be shareholders whose perceived interests conflict. What is not valid however, is a presumption of attaching legitimacy to certain interests held by shareholders which do not warrant such treatment.

If we accept that the proper understanding of the statutory requirement that directors are to act in the best

²⁷⁰ (1989), 571 A. 2d. 1140 (revised written opinion mar. 9 1990) at 1150.

interests of the company means, that which is in the best interests of the shareholders as a whole. And, if we accept that the duties and obligations of directors, as well as the directors' corporate capacity to fulfil their duties and obligations, continues even where a company has become the subject of an unsolicited takeover bid; ²⁷¹ then it would follow that subsumed in this obligation on the part of the directors there exists some act that is capable of promoting an interest that is common to all the shareholders. In which case, there must exist some uniquely shared interest amongst the shareholders. Based on the foregoing, it will be advanced that it may be possible, utilizing the concept of reasonable shareholder expectations, to theorize as to what this commonly shared interest might be. ²⁷²

²⁷¹ Whether the role of directors should remain constant even when their company is faced with an unsolicited takeover bid is of course at the crux of much of the debate.

²⁷² See Cheffins, supra, note 58 at 313, 317; Brian Cheffins, "An Economic Analysis Of The Oppression Remedy: Working Towards A More Coherent Picture Of Corporate Law" (1990) 40 U. of T. L. J. 775, particularly at 781-83. Also see, as was referred to in Cheffins' article, "An Economic Analysis", D. F. Clifford, "Close Corporation Shareholder Reasonable Expectation: The Larger Context" (1987) 22 Wake Forest L. Rev. 41; R. B. Thompson, "Corporate Dissolution and Shareholders' Reasonable Expectation" (1988) 66 Wash. U. L. Q. 193; G Shapira Minority Shareholders' Protection - Recent Developments (1982) 10 N.Z.U.L. Rev. 134; A. B. Afterman, "Statutory Protection For Oppressed Minority Shareholders: A Model For Reform" (1969) 55 Va. L. Rev. 1043. See generally Welling, supra, note 42 at 516-30, 557, 563-564; MacIntosh, "Minority Shareholder Rights", supra, note 60 at 599, 615.

To this end, it is proposed that in determining how best to respond to an unsolicited takeover bid, target directors need only consider legitimate shareholders' interests. Legitimately held shareholder interests are, it is further proposed, derived from reasonable held shareholder expectations. Reasonable shareholder expectations it will be argued, are those expectations genuinely anticipated to occur as the predictable consequence of any given relationship that exists between a company and its shareholders.

With respect to the viability of a theory premised on the notion of reasonable shareholders' expectations, the determination of what is a "reasonable" expectation for a shareholder to hold must at the outset, be amenable to objective analysis. Brian Cheffins considered this point a potential limitation to any theory encompassing notions of reasonable expectations of shareholders without first ensuring the existence of preliminary guidelines as to how such expectations were to be objectively determined.²⁷³ In this light Brian Cheffins noted the favourable developments occurring within the U.S. judiciary with respect to this issue²⁷⁴ and referred specifically to the case of Meiselman v. Meiselman, where the court held that:

²⁷³ Cheffins, "An Economic Analysis", supra, note 272 at 782, 793-94.

²⁷⁴ Ibid. at 782.

...a complaining shareholder's "rights or interests"...include the "reasonable expectations" the complaining shareholder has in the corporation. These "reasonable expectations" are to be ascertained by examining the entire history of the participants' relationship. That history will include the "reasonable expectations" created at the inception of the participants' relationship; those "reasonable expectations" as altered over time; and the "reasonable expectations" which develop as the participants engage in a course of dealing in conducting the affairs of the corporation. ...The key is "reasonable." ...Privately held expectations which are not made known to the other participants are not "reasonable". Only expectations embodied in understandings, express or implied, among the participants should be recognized by the court. ²⁷⁵

Robert B. Thompson in his article "Corporate Dissolution And Shareholders' Reasonable Expectations", discusses the Meiselman case and concurred that expectations if they are to be considered reasonable, can not be unfulfilled hopes and desires. ²⁷⁶

Professor Welling, in discussing shareholders' expectations, referred to the decision of Farley J., in 820099 Ontario Inc. v. Harold E. Ballard Ltd. ²⁷⁷ where the judge commented that, "shareholders expectations [are not] those that a shareholder has as his individual 'wish list'. They must be expectations which could be said to have been (or

²⁷⁵ (1983), 307 S.E. 2d 551 at 563.

²⁷⁶ Supra, note 272 at 218.

²⁷⁷ (Ont. H.C., not yet reported).

ought to have been considered as) part of the compact of the shareholders".²⁷⁸ Professor Welling continues by next referring to the case of Westfair Food Ltd. v. Watt, where the court contrasts "reasonable expectations" with "wishful thinking".²⁷⁹

What these cases illustrate is that, subjective expectations of shareholders would not normally be relevant in determining the reasonable shareholders' expectation. In this vein, reasonable shareholders' expectations can be said to be those expectations that a third party bystander, fully aware of the relationship between a shareholder and his or her company, and the particular business nature of the company itself, would say are reasonable, or more aptly put, would say are not unreasonable expectations that a shareholder could hold.²⁸⁰

One way in which to attempt to objectively determine what are reasonable shareholders' expectations may be to consider the particular nature of the company in which the shareholder

²⁷⁸ Welling, supra, note 42 at 520 & note 199.

²⁷⁹ (1991, Alta. C.A., not yet reported), as cited in Welling, ibid.

²⁸⁰ See Cheffins, "An Economic Analysis" supra, note 272 at 782-83, see also First Edmonton Place Ltd. v. 315888 Alberta Ltd., (1988) 60 A.L.R. (2d) 122 at 146, with respect to an emerging view of an appropriate test being that which is "...objectively in the eyes of a commercial bystander...".

has invested. One might have regard to the traditional practices and customs commonly associated with other companies which function in the same or similar type of business. In respect to establishing what is unfairly prejudicial in considering minority shareholders' statutory oppression remedies, Professor Shapira in his article, "Minority Shareholders' Protection - Recent Developments" said that, "[t]he history, nature and structure of the company, the essential nature of the association, the type of rights affected and general practice should all be material."²⁸¹

MacDonald J. in First Edmonton Place Ltd. v. 315888 Alberta Ltd., in reference to a creditor's application for a statutory remedy against oppression under Alberta's Business Corporations Act, said:

Assuming the absence of fraud, in what other circumstances would a remedy under [the Act]...be available? In deciding what is unfair, the history and nature of the corporation, the essential nature of the relationship between the corporation and the creditor, the type of rights affected and general commercial practice should all be material.²⁸²

This approach was similarly adopted in the case of Lac Minerals Ltd. "Lac" v. International Corona Resources Ltd.

²⁸¹ Supra, note 272 at 146. See Cheffins, "An Economic Analysis", supra, note 272 at 781.

²⁸² Supra, note 280 at 146.

"Corona".²⁸³ In this case Lac (a senior mining company) together with Corona (a junior mining company), entered into serious business negotiations concerning a possible joint venture deal. During the negotiations Corona shared confidential information of positive results on some of their preliminary test drill holes, and of their intent to purchase a certain adjacent track of land where similar positive test result were expected to be located. Lac used this information to purchase the said property from its present owner for their own exclusive use. The case was finally decided in favour of Corona on the basis that Lac had breached a duty of confidentiality owed to Corona, and that the property Lac surreptitiously acquired was to be held in a constructive trust for the benefit of Corona.

Holland J., of the Ontario Supreme Court determined that based on principles of partnership law, (i.e. one partner owes the other a fiduciary duty) that the seriousness of the negotiations that were occurring between Lac and Corona with respect to a possible joint venture, were sufficient to establish that a fiduciary duty did exist between the two parties. In one respect, what is interesting about the decision was how, in determining the existence of a fiduciary duty, Holland J. had referred to the traditional and customary

²⁸³ Supra, note 84.

practices within the mining industry as evidenced at trial.²⁸⁴ Based on this information Holland J. concluded, "...that there is a practice in the mining industry that imposes an obligation when parties are seriously negotiating not to act to the detriment of each other."²⁸⁵ Craig Orr discusses in his article, "The Changing Nature Of Fiduciary Obligations (sic): Part 1", that the two crucial findings of fact made by Holland J. that help to establish the existence of a pervasive customary way of doing business within the mining industry were:

First, there was the admissions by Lac's president that when two geologists in the mining industry are seriously discussing a possible deal, their companies "would both have a duty towards each other not to hurt each other as the result of any information that was exchanged" Secondly, all the expert witnesses called by both parties agreed with that statement and Holland J. therefore concluded that "there is a practice in the mining industry that imposes an obligation when parties are seriously negotiating, not to act to the detriment of each other".²⁸⁶

When this case was finally heard before the Supreme Court of Canada, La Forest J. (in the minority on this point), reaffirmed the findings of the Court of Appeal, in stating that the nature of the special relationship that had developed

²⁸⁴ See International Corona Resources Ltd. v. Lac Mineral Ltd. (1986) 53 O.R. (2d) 737 (H.C.J.) at 765-770.

²⁸⁵ Ibid. at 770.

²⁸⁶ "Part One", supra, note 75 at C-2.

between Lac and Corona was sufficient enough to establish the existence of a fiduciary obligation owing by Lac to Corona. La Forest found this to be so even though fiduciary obligations do not generally arise between commercial parties negotiating at arm's length.²⁸⁷ However, in part based on industrial practices as set out by the evidence adduced at trial, La Forest J., felt that Corona had a legitimate right to expect (reasonable expectations) that Lac would not use confidential information disclosed during business negotiations to its detriment. La Forest stated:

...I have the greatest hesitation in saying that the only circumstances in which a legal obligation can arise out of a notorious business practice is when a contract results. ...It is clear to me that **the practice in the industry** is so well known that at the very least Corona could **reasonable expect** Lac to abide by it...The industry practice therefore, while not conclusive, is entitled to significant weigh in determining the **reasonable expectations** of Corona, and for that matter of Lac regarding how the latter should behave.²⁸⁸ (emphasis mine)

²⁸⁷ Lac, supra, note 84 at S.C.R 643-68, particularly at 656-62.

²⁸⁸ Ibid. at 661-62.

CHAPTER FIVE - PART II

ESTABLISHING REASONABLE SHAREHOLDERS' EXPECTATIONS

It is proposed that objectively discernable reasonable shareholder expectations are, generally speaking, those expectations established at the time an individual subscribed for and is allotted shares in, a company.²⁸⁹ Although shareholders may legitimately form and hold reasonable expectations throughout their association with a company as a consequence of particular events that may transpire, subject to any such overriding occurrences, it is maintained that the expectations formed at the outset of a shareholders' tenure with a company are those that can be said to form the basis for determining legitimate shareholders' interests. It is at this point in time that, again generally speaking, the shareholder's anticipatory expectations for investing in the company are seized. With respect to widely traded public companies at least, it is advanced that the fundamental expectation common to all shareholders at the outset of their relationship with the company, is the expectation that a profit can be made on their investment, wealth maximization being the presumed goal of shareholders generally.

²⁸⁹ See Thompson, 8 supra, note 272 at 213. referring to Professor O'Neal's article "Oppression of Minority Shareholders"; Afterman, supra, note 272 at 1063.

A shareholder investing in a large widely traded company will also will have a variety of what may be termed secondary investment expectations. By illustration, these may be said to be, at least in part that:

-the shareholder will not expect to participate in the affairs of the company beyond that bundle of rights and privileges attached to his or her ownership of shares. (Be those rights and privileges subscribed by the company's articles, by-laws, ordinary or special resolutions, or through applicable statute law.)

-the shareholder does not expect that the company's directors owe a fiduciary obligation to him or her individually, but rather to all shareholders collectively

-the shareholder does not expect the directors to pander to the interests of any particular shareholder or group of shareholders at the expense of the rest of the company

-the shareholder (with the possible exception of an arbitrageur) does not buy shares with the expectation that a takeover bid for their shares will be made.

It would also be a reasonable expectation of a shareholder that the company's affairs will be (and have been

in the past) managed so as to secure continual prosperity for the company. In this vein, shareholders should expect that the company may have to endure short-term costs for the long-term gain. The point is simply illustrated. Capital in the form of retained corporate earnings are expended towards a variety of intra-corporate concerns. Some of the company's retained earnings may go towards research and development projects, or for retooling a factory, hiring and training new employees, advertising, defending or pursuing law suits, and the like. All these are costs of doing business and are a necessity if the company wants to continue to prosper in the years to come.

Although it may well be in their immediate interests, shareholders cannot reasonably expect that upon acquiring shares in a company that corporate revenue normally set aside for necessary corporate expenditures, would instead be diverted into some form of "shareholder payment", be it by dividends or otherwise. Conversely, shareholders do expect that their directors will make "shareholder payments" when they are in a position to do so. Montgomery J. put it well when he said in the case of Olympia & York Enterprises Ltd. v. Hiram Walker Resources Ltd., that "[i]t is the directors' duty to take all reasonable steps to maximize value for all shareholders. There is of course no legal requirement that a company as a going concern, must pay out part of its revenue

to its shareholders. It is however the tactical outcome if a company wishes to retain its present shareholders and be able to seduce new shareholders.²⁹⁰

In tangent with the shareholders' desire for individual wealth maximization, it is further proposed that there exists a "complimentary expectation" on the part of the investing shareholder. Though this latter expectation may not be explicated defined within the minds of the shareholders at the point-in-time that they subscribe for their shares, nevertheless it exists as a general notion, setting out the parameters within which the shareholder expects his or her anticipated desire for wealth maximization will be realized within the corporate structure. This "complimentary expectation" though partly based on a composite of factors unique to the company itself, (e.g. the company's past business record, the present and anticipated trading value of its shares, publicly disclosed business plans, etc.²⁹¹) is primarily grounded on the prevailing and collective perceptions associated with a public company and its corporate management - that being, that a company's board of directors

²⁹⁰ Supra, note 96 at 272.

²⁹¹ This type of information is general reflected in shareholders' expectations as the degree of risk associated with investing in shares of the particular company. The measure of the degree of risk is often reflected in the price and conditions attached to the shares. See generally MacIntosh, "The Shareholders' Appraisal Rights in Canada", supra, bote 34 at 326-27

will endeavour to promote the maximum prosperity of the company.²⁹²

If any singular interests can be said to exist among the shareholders it "...is the continuing sound management and profitability of the corporate enterprise..."²⁹³ To repeat, one leading Canadian corporate text commented:

There is some difficulty in determining what are the best interests of the company or, in other words, what kinds of considerations directors are entitled to take into account in reaching a decision...in determining what constitutes the best interests of the company, the established case law focuses on profit-maximization....Though some courts have demonstrated a willingness to broaden the profit maximization objective, the classical approach remains firmly established. In this state of the law, directors who depart from single-minded profit-seeking are at considerable risk.²⁹⁴

²⁹² The terms "maximum profitability" and "maximum prosperity" are often used synonymously. Strictly speaking however, the term "maximum profitability" could be interpreted to mean a company, through a manipulation of intra-corporate events, endeavouring to achieve a profit margin within a set period of time, that for it, would be its maximum profitability. This "maximum profitability" could be at the expense of the corporation attaining long-term maximum prosperity, which would not be in the company's best interest. For this reason the term "prosperity" is use instead of the term "profitability" in the contest of a corporations aspirations for sustained wealth maximization.

²⁹³ J. L. Warden, supra, note 233 at 1431.

²⁹⁴ Canadian Business Corporations An Analysis Of Recent Legislative Developments, supra, note 14 at 295-296.

Session One of the Paris Colloquium on Corporate Governance which discussed the appropriate role of the board of directors in business corporations, was presented with a draft by the American Law Institute on the principles of corporate governance and structure, which stated that it was the shareholders general expectation that the basic corporate purpose is maximizing corporate prosperity.²⁹⁵ In commenting on the Privy Council decision in Howard Smith v. Ampol Petroleum, John L. Howard suggested that although the Court, "...declares that the directors' function is to manage business operations as distinct from maximizing the value of its shares, that idea is so far removed from commercial reality it cannot be taken seriously in cases involving defences to takeover bids."²⁹⁶

Professors Easterbrook and Fischel referred in their discussion of the perceived benefits of increased premiums for target shareholders in the context of a takeover bid in which target directors are permitted to respond, that one theory of corporate self-interests is that, "[o]rdinary managers are charged with the duty of maximizing the returns to the firm's shareholders without regard to adverse consequences to other

²⁹⁵ (1984) 6 J. of Comp. Bus. & Cap.'t Market L. 201 at 203. See Easterbrook & Fischel, supra, note 30 at 1176, 1190-92.

²⁹⁶ Supra, note 58 at 3.1.18.

firms' shareholders or to society at large." ²⁹⁷

Wealth maximization solely for the sake of shareholders' benefit, has been considered by some as a less than admirable goal, and believe that companies should endeavour to play a broader role within society even if to do so may be at a cost to corporate earnings. ²⁹⁸ No doubt in response to public demand today most large corporations' boards of directors will set their company's agenda to incorporate (at least at a minimum) non-pecuniary considerations. ²⁹⁹ Such alterations to a company's business strategy only makes good business sense, as it recognizes the necessities of doing business in ones community, public perception being so important to retaining customer loyalty. This however, it is advanced, does not abrogate the role of directors or the fundamental expectations of the company's shareholders - which is, that the company through it board of directors will endeavour to secure increasing prosperity. ³⁰⁰ If profit maximization was not the primary goal of companies than it could be argued that

²⁹⁷ Supra, note 30 at 1176.

²⁹⁸ See Dodd supra, note 37 at 1148ff. See generally Gower, Corporate Control: The Battle For The Berkeley, supra, note 55 at 1191-93. But see, Easterbrook & Fischel supra, note 30 at 1190-92.

²⁹⁹ See Dodd, supra, note 37 at 1148-49, 1151.

³⁰⁰ Ibid. at 1152-53. See T. Corcoran, "Even anti-takeover laws can't thwart logical market pressure" The Globe & Mail (1 May 1990) B 2.

potential corporate investors would, instead of buying shares, seek other means of investing their money. This in turn could result in a reduction in the flow of capital within the market place, leading to a downturn in corporate growth, job losses and ultimately a decline in the economy.³⁰¹

To summarize, although actuated out of self-interested motives for maximizing personal gain when purchasing shares in a company, the reasonable expectation of shareholders is that his or her interest in wealth maximization is necessarily commensurate to, and inextricably linked with, the measure of success enjoyed by the company as a going concern. A fortiori, it is the legitimate interests of the shareholder that a company's board of directors manages the business and affairs of the company so as to promote corporate prosperity, which in turn translates into advancing shareholders' interests.

Earl Sneed, in his article, "The Stockholder May Vote As He Pleases: Theory And Fact", discusses the notion of shareholders' self-interests. Sneed commented that shareholders want the welfare of the company to be promoted, for on its success depend their profits. "They [shareholders]

³⁰¹ See generally H. J. Glasbeek, "The Corporate Social Responsibility Movement - The Latest in Maginot Lines to Save Capitalism" (1987/88), 11 Dal. L. Rev. 363, at particularly 381; Easterbrook & Fischel, supra, note 30 at 1191-92.

want the corporation to make the most profit possible.
...Since all stockholders have gathered together in the
corporate composite for the common purpose of seeking
pecuniary gain..." ³⁰²

³⁰² (1960-61) 22 U. of Pitt. L. Rev. 23 at 25.

CHAPTER FIVE - PART III

ASSESSING THE ADEQUACY OF AN UNSOLICITED TAKEOVER BID

If promoting corporate prosperity is the responsibility of the directors, than achieving maximum prosperity for the company must (in this limited sense) be the directors' ultimate goal. Theoretically speaking, if a company was to actually achieve "maximum prosperity", thus having attained its ultimate goal, its continued existence would be fruitless. The company could not hope to prosper beyond that point. When ultimate corporate prosperity is obtained, the best interest of the shareholders will be satisfied and the company should be wound-up, the shareholders enjoying the benefits of the dissolution of the company to the extent their rights as shareholders would entail. The company would owe no obligation to so-called future shareholders.³⁰³

The idea that a company as a going concern, can ever determine its "maximum prosperity" is really a nebulous concept and utterly academic in the day-to-day realities of business. An existing company's maximum prosperity is contingent on a veritable plethora of unknown circumstances and events. If a company is a going concern, it is not

³⁰³ See Gower, supra, note 45 at 573.

possible to determine when it will attain, or for that matter, if it had already attained, "maximum prosperity". It is precisely because of this fact and the fact that directors cannot know what the future holds for their company, that they must seek to balance the "interests" of the present day shareholders, with the "interests" of the future of the company. This is why directors invest in long-term business planning so as to ensure the company's continual ability to strive for enhanced prosperity.

It is, however, possible to argue that this notion of maximum prosperity is relevant when an unsolicited takeover bid is made for a company. It is here that the directors of the target company must evaluate whether the bid is in the best interests of the company. As was discussed above, the best interest of the company is properly understood to mean that which is in the best interest of the shareholders as a whole, which in turn can be properly described as maximizing shareholders' wealth through maximizing corporate prosperity. The role of the target directors and the legitimate interests of the shareholders, it is maintained, does not change when a company has become the subject of a takeover bid.³⁰⁴ What does change as a consequence of a takeover bid being made, is

³⁰⁴ See Iacobucci, "Planning And Implementing Defences To Take-over Bids: The Directors' Role", supra, note 7 at 165, referring to M. Lipton, "Takeover Bids in the Target's Boardroom" (1979) 35 Bus. Lawyer 101 at 113-20.

that there now exists a tangible figure, a "price tag" so to speak, being proffered by the offeror as representative of the target company's true "value". In this context, the maximum prosperity of the company is no longer a nebulous or academic concept contingent on unknown future factors. The actualities of a takeover bid being made "breathes life" into the concept of determining a company's maximum prosperity.

J. B. Harper and A. A. Browne, submitted, "...that under the general law a directors' principal duty in relation to a takeover offer for shares in his company is to ensure to the best of his ability that the shareholders are not induced through ignorance of any material factor to accept a price for their shares which is not commensurate with their true value."³⁰⁵

Obviously target directors could not be allowed to reject out of hand a takeover bid on unsubstantiated grounds that their company would be better off otherwise. Within the finite parameters of the bid, the directors of the target company must determine whether the value of what is being offered adequately reflects the worth of what is being sought. This perceived "worth of the target company" is, for the purposes of determining the adequacy of the bid, the value of the target company's maximum prosperity.

³⁰⁵ Supra, note 62 at 447.

Where a takeover bid involves some form of share exchange in lieu of an all cash deal, or where only a partial bid for the target company's shares is made, the range of potential factors that may properly be considered by the target directors in considering the adequacy of the bid will necessarily become far broader. The target directors may properly consider any number of contingent factors that may foreseeably have a negative impact either upon the shares that are being proffered under the bid; as this directly relates to value of the offer being made, or upon the legitimate interests of those shareholders not targeted under the bid, as this related to the target directors duty to serve the interests of all the shareholders.³⁰⁶ The target directors may consider such factors as, the offeror's general reputation, its past dealings within the business community, the perceived business acumen of the offeror, the offeror's proposed business plans, or the financing arrangement made by the offeror in making its bid.³⁰⁷ It is under this type of a takeover bid scenario that notions of fairness and a balancing of interests may come into play if the best

³⁰⁶ Gore-Browne supra, note 146 at 27-9(w), states that "[w]here a particular decision to be taken by the directors bears differently upon different classes of shareholders, their duty is to act fairly having regard to the interests of all classes.

³⁰⁷ See Pitt, supra, note 4 at 874-75, A. J. Hudec, "Practical Rules for Directors of Takeover Targets" [Jan. 1991] Bus. & The Law 7. See the comments of Berger J. in Teck, supra, note 53 at D.L.R. 317, at W.W.R. 415-16.

interests of the target company would, but for a very small minority shareholders, be advanced should the bid succeed.

In attempting to determine the adequacy of the bid, the target directors should be permitted to consider the value of their company as a going concern. Clearly, in determining "value" the target directors should be allowed to consider a wide variety of factors and events that can be said to impact positively upon the prosperity of the company. In determining the "maximum prosperity value" of a company, target directors should also be permitted to take into consideration anticipatory factors or events that will impact positively upon the interests of their company even though such corporate benefits will accrue ex post facto that point in time in which the adequacy of the takeover bid is being assessed. When such considerations are legitimately factored into the analysis they may demonstrate that the target shareholders would be in a superior position if the bid did not succeed.³⁰⁸ Robert W. Hillman cautions that:

³⁰⁸ Sommer, supra, note 55 at 51.

Further a court should not grant relief for failure to achieve expectations within an unreasonable period of time...

Obviously, an individual commits capital to a venture with the expectation that a return will be forthcoming.... The problem becomes one of determining when it is reasonable to expect a return on capital, and to a large extent this should depend upon the assumption and expectations of the parties which formed the basis for the venture.³⁰⁹

The notion of determining a company's "maximum prosperity value", is of course a relative term, and requires a point of reference. How far afield; how speculative, can target directors reasonably project what the anticipated maximum prosperity of their company would be? It is said that, "[l]ong-term profitability is a very broad principle, one which allows management great flexibility. However, this flexibility does not permit management to pursue every course of action which it might believe the corporation should in good conscience take."³¹⁰

It is proposed that target directors ought to be limited to considering only those factors or events that are reasonably foreseeable and genuinely anticipated to occur.

³⁰⁹ "The Dissatisfied Participant in the Solvent Business Venture: A Consideration of the Relative Permanence of Partnerships and Close Corporations" (1982/83) 67 Minn. L. Rev. 1 at 79 & note 248.

³¹⁰ "Session One", supra, note 295 at 203.

This implies that some kind of business strategy or plan for the target company had been implemented prior to the takeover bid being made. In this way, the target directors should be permitted to calculate into their assessment of the adequacy of the takeover bid, the anticipated increase in prosperity that their company would have enjoyed at the expiration of a business plan, as that increase in corporate prosperity can be described as a current asset of the target company.

What is a "reasonable business plan" in terms of what is assumed that can be achieved under the plan and the duration of time it would take to attain its goals, will undoubtedly be a matter of debate. One obvious problem with permitting target directors to consider anticipatory prosperity based on long-term business or plans for their companies, is the potential for abuse. An otherwise adequate takeover bid could be rejected by the board of directors of the target company as not being in the best interests of the company and its shareholders, under the guise of, or in the mistaken belief that, the target company and its shareholders would enjoy superior benefits being offered under the long-term business plan. ³¹¹

³¹¹ See J. J. Lerner, "Did the Time Decision Torpedo the Hostile Bid?" (Feb. 1990) Vol. 24, No. 4 Mergers & Acquisitions 41 at 42; R. E. Bull, "Directors' Responsibilities And Shareholders' Interests In The Aftermath Of Paramount Communications v. Time, Inc." (1990) 65 Chicago-Kent L. Rev. at 915-16.

The propensity that when a takeover bid is made there will be directors who are motivated out of self-interest to engage in defensive tactics regardless of the merits of the bid, is a very real problem. The necessity to establish checks to counter such conduct is a legitimate concern for all who participate within the financial market places of North America. The question remains however, by what means is this best achieved?

A major case out of the state of Delaware recently, was that of Paramount Communications, Inc. v. Time Inc.³¹² Briefly in this case, the Supreme Court of Delaware rejected Paramount's appeal for an injunction prohibiting the board of directors of Time from completing a planned merger/acquisition with Warner Communications, Inc. Paramount and other shareholders of Time argued that the injunction should be granted because:

(1) the original deal reached with Warner was tantamount to a sale of corporate control of Time, and therefore the so-called "Revlon mode" was triggered, and the directors of Time were required to accept Paramount's higher bid. (The "Revlon mode", was named after the case in which this judicial test was first articulated - Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc. in which case the

³¹² Supra, note 270.

court held that where the sale of the company is imminent, the target directors have a fiduciary duty to seek that highest possible price available so as to maximize shareholders' value).³¹³

(2) that the second deal struck between Time and Warner was an unreasonable response to any perceived threat that the Paramount offer could pose, and therefore, the directors of Time acted improperly. (The notion that a response to a takeover bid must be reasonable, that is, in proportion to the actual threat a takeover bid posed to the policies and affectiveness of the target company, was first articulated into a judicial test, in the case of Unocal Corp. v. Mesa Petroleum Co.).³¹⁴

Briefly the facts of Paramount Communications, Inc. v. Time Inc. are that, in 1987 Time was considering expanding its business interests within the communication industry. In particular, Time was interested in some type of venture with one of the major movie producing/entertainment companies, (Paramount, Disney, Twentieth Century Fox, Universal, and Warner were all considered). In the end the Time directors decided to enter discussion with Warner, whom the Time board felt offered their company the best potential option for its

³¹³ 506 A.2d 173 (Del. 1986) at 183.

³¹⁴ 493 A.2d 946 (Del.1985) at 955.

required needs and aspirations for future growth and prosperity. Initial negotiations failed, primarily because of disagreements over who would retain effective managerial control of the merged companies. Time's directors wanted control to ensure the continuation of its perceived "corporate culture".³¹⁵ Eventually however, an agreement in principle between the two companies was reached, but because Time was offering Warner shares in its organization, Time's management required their shareholders' approval, which was to be sought at the upcoming annual meeting of shareholders. Prior to this meeting taking place, Paramount made a takeover bid for Time. It was an all cash, all common share offer, that eventually reach \$200 per share. Time's management rejected the Paramount deal as not being in the best interest of the company, and thereafter altered the arrangements previously made with Warner to primarily an all cash deal, thereby superseded the necessity to obtain shareholder approval.

What is important to note about the Court's decision dismissing Paramount's request for the injunction, was their acceptance of the probity of the Time's directors taking into

³¹⁵ Ironically it was N. J. Nicholas, Time's former president and co-chief executive officer of Time Warner Inc., that recently resigned over what was termed a clash of corporate cultures within the board of directors. The helm of the company is now controlled by Steven Ross Warner's former chairman. See Reuters, "Nicholas quits Time Warner" The Globe & Mail (21 Feb. 1992) B2, S. Wollenberg, "Lingering discord at Time Warner" The Globe & Mail (22 Feb. 1992) B 7.

consideration the company's long-term business plans, when evaluating the adequacy of the takeover offer.³¹⁶ The court made two key findings in this case. One determination made by the Court was the fact that the directors of Time could demonstrate that there did indeed exist a long-term business strategy for their company prior to Paramount's takeover bid having been made. The court stated that, "[w]e have purposely detailed the evidence of the Time board's deliberative approach, beginning in 1983-84, to expand itself. Time's decision in 1988 to combine with Warner was made only after what could be fairly characterized as an exhaustive appraisal of Time's future as a corporation."³¹⁷

Secondly, it was determined that the directors of Time had reasonably assessed that the projected prosperity for their target company, (hence its shareholders) would be superior if Paramount's \$200 per share offer was rebuffed and Time's long-term business strategies were allowed to proceed as planned.³¹⁸

The Court rejected the notion that when confronted with Paramount's bid, the board of directors of Time were limited in evaluating the offer from the perspective of whether or not

³¹⁶ Specifically, in determining that the Time-Warner agreement was the product of a proper exercise of business judgment, *supra*, note 270 at 1151-52.

³¹⁷ Ibid. at 1151.

³¹⁸ Ibid. at 1149.

the bid adequately reflected the present value of the company. The Court acknowledged that Time's directors could consider the implications of a takeover affecting the future prosperity of their company as set out in their long-term business strategy. The judicial deference paid to Time's commitment to retain its corporate culture was also another consideration accepted by the Court in deciding in Time's favour.³¹⁹ The whole idea of a corporate culture is a new concept in company law. It appears that Time persuaded the court that its unique brand of management skills was an important factor in the overall value of the company. (Implicit in Time's argument is that Paramount lacked similar management skills that would be of equal value to the company should their bid succeed.) What is not clear from the court's decision is exactly how relevant the notion of a company's perceived "corporate culture" is in determining what is in the best interests of the shareholders.

It is also important to note that the Delaware Supreme Court would not entertain as relevant, arguments pertaining to the notion of the time value of money. The Supreme Court of Delaware rejected the idea that courts should be considering such issues, stating that, "[t]he open-ended analysis mandated by Unocal is not intended to lead to a simple mathematical

³¹⁹ Ibid. at 1149, 1152, 1154. See Bull, supra, note 311, at 915-16.

exercise: that is, of comparing the discounted value of Time-Warner's expected trading price at some future date with Paramount's offer and determining which is the higher." ³²⁰ It would appear however, to be an important factor for either party to address, but specially so from Paramount's perspective in trying to discredit Time's assertion that their offer was inadequate. It would seem, at least in part, that for Time's directors to determine that their shareholders would be in a superior position if the Warner deal went through, they must have addressed their minds to the issue of the time value of money. That is, they must have, (or at least, they should have) considered where their shareholders would be in terms of an aggregate increase in the value of their shares at the end of the proposed business plan, to where they would have been at the same point-in-time, had the Paramount's bid succeeded.

"Time's advisor had projected long-term trading ranges after the merger of \$159-257 for 1991, \$230-332 for 1992 and \$204-402 for 1993. On the Paramount side, a \$200 per share offer could have been invested, and at 12% would have been worth by mid 1994, approximately \$352." ³²¹ It should be noted that despite Time's prediction, Time-Warner shares are currently trading on the New York Stock Exchange on the 10th

³²⁰ Supra, note 270 at 1153.

³²¹ See Bull, supra, note 311 at 909.

of December 1992 at U.S.\$28.³²²

Paramount might have also wanted to consider in their argument, the "risk factors" that are always present in any long-term business plan such as the one being relied upon by Time as the basis for rejecting their cash offer. Paramount could have argued that any estimate of the future value of the Time-Warner shares should be proportionately discounted by a figure determined to reflect these "risk factors" that the shareholders of Time-Warner would have to endure over that period of time called for under the plan proposed by Time's management to produce the results speculated.

The court in the Paramount case made another important observation, and that was that it was up to the directors (not the shareholders) to determine the time frame for achieving corporate goals. The Court held that where there exists a reasonable likelihood that the interests of a target company will be advanced from business plans implemented by its directors, the directors were under no obligation to abandon such plans for the sake of a short-term benefit. The court posed the question; "Did Time's board, having developed a strategic plan of global expansion to be launched through a business combination with Warner, come under a fiduciary duty

³²² Ibid. See R. Lowenstein, "Time Warner anticipates merger" The Globe & Mail (24 June 1991) B 8.

to jettison its plan and put the corporation's future in the hands of its shareholders?"³²³ Obviously in the opinion of the Supreme Court of Delaware, they did not.

The decision in Paramount Communications, Inc. v. Time Inc. reaffirms the long standing opinion within the judiciary, (both the Anglo-Canadian and the American judiciaries) that it is up to the directors and not the shareholders to manage the business affairs of a company. This case also confirms, for U.S. directors at least, the acceptability of considering the company's long-term business strategies when evaluating what is in the best interests of the company and its shareholders.

Jonathan J. Lerner, who discusses the decision of Paramount case in his article, "Did the Time Decision Torpedo the Hostile Bid?", had this to say about the right of directors to consider long-term corporate planning; "[b]ecause of the Time-Warner-Paramount decision, corporate boards can use long-range strategies as rationales for rejecting acquisition offers. While increasing directors' flexibility, the Delaware court ruling stopped short of giving them a blank check to "just say no" in any case."³²⁴ Robert E. Bull, similarly expresses his strong concerns that the Paramount

³²³ Supra, note 270 at 1149-50.

³²⁴ Supra, note 311 at 41.

case gives target directors too much power if all they have to show is there exist a long-term strategic plan, the point being that long-term plans are too speculative.³²⁵

Interestingly, in the Paramount case, Time's directors were permitted to alter the original deal with Warner specifically to avoid having to go to the shareholders for their approval.³²⁶ The threat posed by the Paramount bid, according to Time's directors, was that though they had determined the bid to be inadequate, there existed a possibility that Time's shareholders would tender their shares regardless, having been blinded as to what was truly in their best interests by the immediate allure of Paramount's cash offer. The Court accepted that "Time shareholders might elect to tender into Paramount's cash offer in ignorance or mistaken belief of the strategic benefits which a business combination with Warner might produce".³²⁷

³²⁵ Supra, note 311 at 914-17. See however D. S. Cahill & S. P. Wink, "Time and Time Again the Board is Paramount: The Evolution of the Unocal Standard and the Revlon Trigger Through Paramount v. Time" (1990) 66 Notre Dame L. Rev. 159. See generally L. A. Duda, "Paramount Communications, Inc. v. Time Inc.: A Decision Of Paramount Significance?" (1991) 16 The Delaware J. of Corp. L. 141.

³²⁶ Supra, note 270 1153.

³²⁷ Supra, note 270 at 1153. See T. M. Hackett, "Paramount Communications, Inc. v. Time Inc.: Taking the Teeth Out of Proportionality Review" (1990) 22 Loyola U. of Chicago L. J. 229 at 242-43.

Of the Australian case Darvall v. North Sydney Brick & Tire Co. Ltd.,³²⁸ John Farrar discusses the decision rendered by Hodgson J, and of Hodgson's acceptance that "...where directors are of the view that many shareholders will accept a takeover offer and are also of the view that it would be disadvantageous to them, they may cause the company to enter into agreements with a third party to demonstrate to the shareholders that it is not in their interests to accept the offer, provided that the agreements in question advance the commercial interests of the company."³²⁹

Contrast the approach taken in Paramount, and referred to in the Darvall case, with our National Policy No. 38, Take-Over Bids - Defensive Tactics, as promulgated by the Canadian Securities Administrators.³³⁰ National Policy 38 strongly suggested that though target directors may, in responding to an unsolicited takeover bid, engage in defensive tactics, the actions taken must not deny their shareholders the opportunity to respond to the bid or to any competing bids.³³¹ Frank Iacobucci, in his article "Planning And Implementing Defences

³²⁸ (1988), 12 A.C.L.R. 537.

³²⁹ Farrar, *supra*, note 1 at 35-36. Actions taken for the purpose of "advancing the commercial interests of the company" can arguably be defended on a basis of anticipated future prosperity for the company.

³³⁰ Supra, note 39.

³³¹ Ibid.

To Takeover Bids: The Directors' Role", expressed similar sentiments, arguing that, "[s]hareholders should enjoy the fundamental rights of disposing of their shares and of deciding who shall run the affairs of the corporation, free from directors interference".³³²

A policy that restricts the role of target directors and encourages their passivity in the context of an unsolicited takeover bid, arguably contradict basic corporate law doctrine that it is up to the directors, not the shareholders, to decide what is in the best interests of the company. It seems that under National Policy 38, the analysis is that the making of a takeover bid fundamentally alters the role of the target directors who must, once the bid is announced, abdicate their obligations even where the better interests of the company could be threatened by doing so.³³³

Even if one accepts, as is advanced by our Canadian securities regulators, that shareholders' interests are better served where a competitive auction for control occurs,³³⁴ it does not necessarily follow that target shareholders ought to have at all times, the ability to respond to a takeover bid or

³³² Supra, note 7 at 165-66. See also Harper supra, note 62 at 449. See generally J. L. Howard, "Fiduciary Relations In Corporate Law", supra, note 42 at 74-77.

³³³ See St. Patrick Baxter, supra, note 33 at 100.

³³⁴ For contrary view see Gillen, supra, note 1.

to a competing bid. If we accept the chronology of corporate management as unchanged in the context of an unsolicited takeover bid; and if the target directors have already bona fide in the proper execution of their duties determined that the initial bid or a competing bid was inadequate and therefore not in the best interests of the company; what further interests are served by requiring as a general rule, that the target shareholders have the right to respond to the takeover bid or any competing bid?

It would appear, based on the recent decision of the Ontario Securities Commission in re: Canadian Jorex Limited, released in January of this year,³³⁵ that where target directors implement defensive tactics of a shareholders' rights plan in response to a takeover bid without obtaining prior shareholder approval,³³⁶ and where such action results in denying the target shareholders the ability to respond to the initial bid or any subsequent competing bids, the directors must be able to demonstrate that the tactics

³³⁵ (1992), 15 Ontario Securities Commission Bulletin 257, chpt. 3 at 1, see the commentary prepared by G.W. Voorheis, G.R.M. Hayden and P.D. Davis, of Davies, Ward & Beck, Toronto, January 28, 1992. Out of the 34 or so existing poison pill plan in Canada, Jorex's was the first to be disallowed by the Ontario Securities Commission. see C. Motherwell, "OSC enters Canadian Jorex takeover battle" The Globe & Mail (19 Dec. 1991) B 11, A. Robinson, "OSC ruling expected on Jorex poison pill" The Globe & Mail (20 Dec. 1991) B 5.

³³⁶ With respect to the board of directors obtaining prior approval of the shareholders see generally, J. G. Howard, supra, note 7 at 76. But see Farrar, supra, note 1 at 40.

implemented served a "useful purpose". It would also appear, given the general tenor of National Policy 38, that the only useful purpose served under such circumstances would be if no offer made for a company which was the subject of a takeover bid, came even remotely close to reflecting the true and intrinsic value of the company, and that despite this fact being made known to the target shareholders, there was a real possibility that the target shareholders would be induced to accept such a bid nonetheless.

Arguably the provisions of National Policy No. 38, if taken to their extreme, may unreasonably deprive target directors of an option that would in fact be in the best interests of the shareholders. The Paramount case is an example of how even a non-coercive takeover bid (as will typically to be the case here in Canada under our more stringent takeover bid rules ³³⁷) may (albeit a rarity), be bona fide rejected by the target directors even where to do so encompassed a purposive plan to evade any involvement of the company's shareholders. Peter Dey and Robert Yalden pointed out in their article, "Keeping The Playing Field Level: Poison

³³⁷ Since initial efforts to bring order and fairness to takeover bids in Canada began, (around the 1960s) numerous rules and regulations have been imposed in an effort to ensure that the target shareholders are treated equally, fairly, and free from most types of coercive tactics that an offeror may be permitted to use in the U.S. See MacIntosh, "Noxious Nostrum" supra, note 33 at 301; Feltham, supra, note 82 at 321-23.

Pills And Directors' Fiduciary Duties In Canadian Take-Over Law", that although securities laws are generally designed to remedy deficiencies in our corporate law, at times corporate law instead of securities rules may in fact be better for shareholders interests. ³³⁸ Peter Dey who acted on behalf of Jorex as legal counsel said that, "[t]he defensive tactics of a company should be "left to the privacy of the board room. The OSC should not substitute its judgment for the board of directors." ³³⁹

The securities regulators in Canada have mandated that the protection of the investing public in corporate control situations is paramount. The problem may be that in their efforts to protect the public, overzealous initiative, undertaken to discourage unethical or irresponsible behaviour on the part of some target directors, may place too onerous a burden on the sedulous target directors who might otherwise be prepared to implement novel, innovative and necessary defensive tactics in order to serve the best interests of the company and its shareholders. If one accepts the proposition that a benefit may be incurred by target shareholders when their company's board of directors is actively involved in the takeover bid process, then it can be argued that any

³³⁸ Supra, note 6 at 252.

³³⁹ A. Robinson, "Jorex told to dissolve poison pill" The Globe & mail (21 Dec. 1991) B 5.

unreasonable over-policing of target directors may attenuate the welfare of those interests for whom such policies were implemented in the first place.³⁴⁰

³⁴⁰ See the comments of Professor Berle, supra, note 37 at 1149-50.

CHAPTER SIX**CONCLUSION**

How directors should or should not be managing their companies has been the focus of much discussion over the years to be sure. Wisely, however, the judiciary has always retained its distance in considering such matters. Legislators too, trespass lightly into the domain of corporate management. The reason of course is that the affairs of business are at best capricious, and more often volatile in their nature. Correspondingly, it has been the prevailing wisdom that in order to react quickly and advantageously within the business community, directors require a good deal of latitude. Such circumstances necessarily do not lend themselves well to the dictates of strict dogma. Much the same can be said about how directors should properly be responding when an unsolicited takeover bid is made for their company. Although the law broadly states that directors are to act in the best interests of the company, in the context of an unsolicited takeover bid, what is in the "best interests of the company" remains today a matter of some debate.

In this thesis I proposed the notion of using legitimate shareholders' interests as a possible means for understanding

both what is meant by the phrase "the best interests of the company" and the role directors have to play in endeavouring to promote these interests. In theory it was argued that reasonable shareholder expectations determine legitimate shareholder's interests, which in turn dictates the role directors play in the management of the company. Based on objectively definable shareholders' expectations, a shareholder's primary concern is for wealth maximization, which it was argued, is understood by the shareholder as being intricately paired with the fiscal wellbeing of their company. The common interest therefore of the shareholders as a whole is the promotion of corporate prosperity. When confronted with a corporate control situation, such as that which presents itself when an unsolicited takeover bid for a company is announced, the theory continues that, barring any unusual circumstances that may have occurred throughout a shareholder association with the company, his or her legitimate interests are that the board of directors will, in responding to the bid, endeavour to promote the corporate prosperity of the company.

Within the confines of a takeover bid the prosperity of the company equates to the adequacy of the offer. Although some target shareholders may wish to avail themselves to the unexpected windfall that a takeover bid might bring, they cannot justifiably maintain that position if the bid is

determined to be inadequate, because it has never been within the shareholder's genuinely held expectations that their board of directors would sacrifice corporate prosperity for short-term shareholder interests. Nor could shareholders maintain that they have a right to the premiums offered. Richard Brown said that the, "[c]ourts, however, have found that shareholders do not possess any absolute contractual right to receive takeover bids. Rather, the shareholders' ability to gain premiums from takeover activity is subject to the exercise of the good faith business judgments of the board of directors in structuring appropriate defensive tactic."³⁴¹ While Mr. Brown was referring to the U.S. judiciary, similar sentiments can be said to apply here in Canada.³⁴²

While the company exists as an ongoing concern the directors' agenda is set, they are required to orchestrate the business and affairs of the company, which includes responding to an unsolicited takeover bid, so as to promote the company's maximum prosperity.

In conclusion it is suggested that this singularity of character with respect to the board of directors' duty in responding to an unsolicited takeover bid, affords us with a

³⁴¹ Supra, note 24 at 213.

³⁴² However National Policy No. 38 could considerably alter the status quo in its present form.

more reliable means of assessing the propriety of directors' conduct.

Dean Clark of the Harvard Law School, suggested that to try to analyze the appropriateness of how directors responded to an unsolicited takeover bid based on some kind of "fairness" standard would be insufficient because the content of "fairness" was too broad. Dean Clark felt that:

A single goal like profit maximization is more easily monitored than a multiple, vaguely defined goal like the fair and reasonable accommodation of all affected interests.... Assuming shareholders have some control mechanisms, better monitoring means that corporate managers will be kept more accountable. They are more likely to do what they are suppose to do and do it efficiently. ³⁴³

The idea of utilizing shareholder's expectation as a means of inferring duties and obligations was discussed by Lord Wilberforce, in Ebrahim v. Westbourne Galleries Ltd., where his Lordship stated that, "... a limited company is more than a mere legal entity, with a personality in law of its own: that there is room in company law for recognition of the fact that behind it, or amongst it, there are individuals, with rights, expectations and obligations inter se which are

³⁴³ See J. L. Howard, "Fiduciary Obligations", supra, note 58 at 3.1.08 & note 30; Sommer, supra, note 55 at 54. But see Shapira, supra, note 272 at 145.

not necessarily submerged in the company structure.³⁴⁴

The judicial use of the concept of shareholder's expectations is still however an emerging concept. This was pointed out by Donald F. Clifford in his article, "Close Corporation Shareholders Reasonable Expectations: The Larger Context". Clifford states:

There are not, however, enough cases to clarify the contours of that doctrine. Such a stage is inevitable in the evolution of the law. As the cases increase, even more questions will arise. Is "disappointment" enough? What is reasonable? Whose expectations? When must the expectations have arisen? Are the expectations born of contract or of status? Are they related to fiduciary obligations? Can they be "limited" by contract?"³⁴⁵

In the United States the notion of utilizing shareholder's expectations has, since about the early 1980s, been acquiring a good deal of consideration.³⁴⁶ However, as Brian Cheffins pointed out, the same cannot as yet, be said about Canada.³⁴⁷ Although Cheffins did note that the wide acceptance by the U.S. judiciary of the validity of using shareholders' expectations, was likely indicia that this

³⁴⁴ [1973] A.C. 360, [1972] 2 All E.R. 492 (Eng. H.L.) at 500. See MacIntosh, "Minority Shareholders' Rights in Canada", supra, note 60 at 618.

³⁴⁵ Supra, note 272 at 41.

³⁴⁶ Ibid. & note 2.

³⁴⁷ "An Economic Analysis" supra, note 272 at 781-82.

concept would attain increasing acceptance here in Canada.

³⁴⁸ Like Brian Cheffins, Professor Welling has dealt with the notion of shareholder expectation in Canada when dealing with issues concerning the oppression remedy. Professor Welling commented that Canadian courts are beginning to use the notion of shareholder expectations, and that our courts "have clearly seen that legitimate shareholder expectations can arise in many different situations...." ³⁴⁹

One of the earlier cases that dealt with the concept of shareholders' expectations was Diligent v. R.W.M.D. Operations Kelowna Ltd., in which case, Fulton J., comments that the concept of considering shareholder's expectations as an approach that would, "rationalize what has been presented by some as an equation with the shareholders on one side and the company on the other, with different interest". ³⁵⁰

In the case of First Edmonton Place Ltd. v. 315888 Alberta Ltd. ³⁵¹ a small firm of lawyers from Edmonton had a management company, which acquired a business rental lease for a suite of offices. The management company was controlled by the same group of lawyers, who were its shareholders and

³⁴⁸ Ibid.

³⁴⁹ Supra, note 42 at 520.

³⁵⁰ (1976) 1 B.C.L.R. 36 at 51.

³⁵¹ (1988), 60 A.L.R. (2d) 122.

directors. The premises were subsequently subleased by the management company to the lawyers but without executing a subleasing agreement. The lease signed by the management company was for ten years with an 18-month rent-free period, a leasehold improvement allowance of \$115,900, and a signing bonus of \$140,126 that was subsequently paid over to the lawyers.³⁵² The lawyers vacated the premises three months after the free 18 month rent free period had elapsed.

In part, MacDonald J. had to consider whether the plaintiff lessor (in fact, the subsequent lessor) had the proper status to bring a derivative action under the province's Business Corporations Act, in the name of the management company and against the defendant directors. The Court exercising its discretion under the Act, determined that the lessor should be allowed to bring a derivative action as being a "proper complainant". MacDonald J., referring to Deligenti v. R.W.M.D. Operations Kelowna Ltd., and quoting from Professor Shapira's article, "Minority Shareholders' Protection - Recent Developments"³⁵³ that:

³⁵² See headnote, Ibid. at 122-24.

³⁵³ (1982-83) 10 N.Z.U.L. Rev. 134.

Whereas in the past good faith and the constitutional power of the directors and the majority had been critical, the emphasis shifted to the damaging effect on the interests set out in [the Act]. These interests include "equitable rights" based on legitimate expectations. The "underlying intentions, understandings, and expectations of the participants provide an analytical framework within which the concept of unfair prejudice can be developed". Expectations will vary considerably with the size, structure and nature of the corporation, as well as the circumstances surrounding the applicant's association with the corporation.³⁵⁴

MacDonald J. went on to say that, "...the court might hold that the applicant is a "proper person to make an application" for an order under [the Act] if the act or conduct of the directors or management of the corporation which is complained of constituted a breach of the underlying expectation of the applicant arising from the circumstances in which the applicant's relationship with the corporation arose".³⁵⁵

The concept of shareholders' expectations is, at least in part, an extension of a broader economic based theory; a theory that sees the concept of "the company", its existence in society and the laws that have been built-up over the years to regulate it, as all being inter-connected to a wider underlying and unifying idea based on economics. Very

³⁵⁴ First Edmonton Place, supra, note 280 at 144.

³⁵⁵ Ibid. at 152.

briefly, this economic theory tends to view a company as an entity existing for the purpose of facilitating cost effective transactions between people which, sans the corporate entity, would otherwise have to take place at a higher transaction cost. Within this corporate entity (generally the discussion is in respect to closed corporations) the rights, duties and obligations that can exist vis-a-vis the shareholders, directors and the company, are frequently left unspoken and unwritten because to do otherwise would be too expensive and therefore inefficient. Subsumed in this theory is the fact that courts should look not only to the explicit agreements made between the corporation and its shareholders, but also to the implicit, (i.e., the unspoken and unwritten) understandings that may exist between the parties.³⁵⁶ This introspective analysis can be achieved at least in part, by examining shareholders' expectations.

Even if one were to reject the economic analysis approach, and instead rely on a more traditional analysis of the appropriate role of directors based on fiduciary law principles, the concept and the viability of using shareholders' reasonable expectations would not necessarily also have to be discounted. Shareholders' expectations may be complementary to the fiduciary law jurisprudence. John A. C.

³⁵⁶ See Cheffins, "An Economic Analysis", supra, 272 at 783ff. See also K. Lehn, "Majority-Minority Relationships-An Economic View" (1988-87) 12-13 Can-U.S. L. J. 135.

Hetherington has advanced that:

There can be no question that the purpose of legally imposed fiduciary obligations is to induce managers to act in conformity with the expectations and interests of the shareholders. It would seem to follow that the boundaries or limits of managers' obligations should be sought in the express and implied contemplations of the parties, rather than in the immutable dogmas of judicial rhetoric invoking "inveterate" principles.³⁵⁷

In the U.S. case of Lowder v. All Star Mills, the court expressed its opinion that shareholder's reasonable expectations can include ordinary obligations of corporate fiduciaries, stating that, "...some cases have explicitly acknowledged that how the fiduciary performs obligations is part and parcel of reasonable expectations..."³⁵⁸

Donald Clifford has postulated that, "[t]he more one looks, the more the notions of 'reasonable expectations' appear to be near the centre of the legal universe."³⁵⁹ Clifford goes on to cite authority for his proposition stating that:

³⁵⁷ "Defining the Scope of Controlling Shareholders' Fiduciary Responsibilities" (1987-88) *Can - U.S. L. J.* 103 at 110.

³⁵⁸ *Inc. 75 N. C. App.* 233, at 240-42, 330 S.E. 2d 649 at 654 (1985) as cited in Clifford's article, "Close Corporation Shareholder Reasonable Expectations", *supra*, note 272 at 52 & note 64.

³⁵⁹ *Supra*, note 272, at 42.

The first section of Corbin's classic treatise on Contracts is entitled "The Main Purpose of Contract Law is the Realization of Reasonable Expectations Induced by Promise. ...Tort law, of course, is thoroughly immersed in "reasonable expectations". ...As the extraordinary English scholar P. S. Atiyah pointed out, the attributes of our property law are grounded in expectations."³⁶⁰

Clifford than quotes directly from text, The Rise And Fall Of Freedom Of Contract:

The truth is that expectations are becoming more and more divorced from promises. On the one hand, certain expectations are today accorded greater recognition, because they are more powerfully held. These expectations do not necessarily arise from promises, still less from contract. They arise from the modern way of life.³⁶¹

Philip Anisman discussed expectation of shareholders and the growing acceptance within the Canadian judiciary of determining fairness based on the expectation of the parties, at least in closely held companies.³⁶² So too does Professor MacIntosh.³⁶³

The notion of shareholders' expectation has invariably been applied to situations involving minority shareholders in

³⁶⁰ Ibid. at 42.

³⁶¹ Ibid. at 43.

³⁶² Supra, note 60 at 92-93.

³⁶³ See "Minority Shareholders' Rights in Canada", supra, note 60 at 599, 615.

closed corporations. The reason for this may in part be the result of the courts' acceptance over the years to intercede on the behave of minority shareholders who were more or less helpless to stop abuses of power by majority shareholders and/or directors. ³⁶⁴

Brian Cheffins points out that the courts are reluctant to get involved in the affairs of shareholders of large corporations because dissatisfied shareholders (minority or not) generally have a market in which they can dispose of their shares if they so choose. Cheffins goes on to say that, "[f]urther, in widely held corporation, the shareholder expectations and understanding relating to employment, management and other matters which are so often the components of shareholder dissatisfaction are unlikely to arise." ³⁶⁵ Be that as it may, it should not be discounted that shareholders in large publicly held companies are void of expectations. Robert B. Thompson, while focusing his discussion of shareholders' expectations in closely held companies nevertheless recognized that, "[t]he court [appellate court of New York] recognized that shareholders' expectations in a close corporation differ from shareholders' expectations in publicly held corporations ..."

³⁶⁴ See Anisman, supra, note 60; Thompson, supra, note 272 at 196-98.

³⁶⁵ Supra, note 58 at 317.

J. G. MacIntosh points out that Dixon J. in, Peter's American Delicacy Ltd. v. Heath, while dealing with the issue of majority versus minority shareholders rights and obligations, "...recognized that, even for large public corporations, the exercise of apparently unrestricted powers might be conditioned by legitimate shareholder expectations, a principle whose full import is only now in the process of full elaboration." ³⁶⁶

Professor Welling has stated, that the, "...principle of shareholder expectation is not restricted to small, closely held "partnership analogy" corporations, though it is more likely to arise and to generate judicial sympathy in those situations." ³⁶⁷

It is advanced that the concept of shareholders' expectations is an expansive approach, which, when the appropriate circumstances are present, can be applied to any corporate situation. Its use need not be relegated within the confines of closely held corporations. In extraordinary corporate scenarios, such as when an unsolicited takeover bid of a public company is made, the general availability of a market for the shares of that company is unlikely to placate

³⁶⁶ (1938-39), 61 C.L.R. 457, as cited in MacIntosh, "Minority Shareholders' Rights in Canada" supra, note 60 at 614.

³⁶⁷ Supra, note 42 at 517.

the frustration of those target shareholders who perceive that their legitimate interests were improperly interfered with because of the alleged inappropriate conduct of their directors. In these types of situations, it is suggested that a better understanding of the merits of any complaint respective to the conduct of the target directors may be advanced by applying an analytical approach encompassing notions of legitimate shareholders' interests based on reasonable shareholders' expectations as was argued in this paper.

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