THE GLOBE AND MAIL

Opinion

Publicly traded companies need more recourse when mergers fall through

Gesta Abols, Neil Kravitz and Brad Moore

Special to The Globe and Mail

Published January 1, 2025 Updated January 2, 2025

Gesta Abols, Neil Kravitz and Brad Moore are partners at Fasken Martineau DuMoulin LLP. The views expressed herein are those of the authors.

Imagine you sign an agreement of purchase and sale to sell your house for $1-million after a bidding war, but after the buyer illegitimately backs out, you're only able to sell it for $800,000. The law is clear as day that you can sue the first, delinquent buyer for the difference, namely $200,000. Somewhat strangely, however, it doesn't always work the same way where Canadian public companies are involved. That's bad for everyone from retail investors to pension funds, and changes should be considered to better protect them. Delaware showed the way in 2024. Canadian lawmakers should follow its lead.

This problem was on full display in a billion-dollar M&A dispute that arose during the pandemic. Cineworld Group plc, an LSE-listed company, agreed to acquire Cineplex Inc. CGX-T -0.81% decrease, a TSX-listed company, in December, 2019. But in June, 2020, just two months before the deal was to close, Cineworld backed out.

After an Ontario court ruled that Cineworld did not have legal grounds to end the deal, the question became how to calculate the damages Cineworld should pay Cineplex. The court ultimately awarded damages of $1.24-billion, but its reasoning was curious. Similar to our home sale example, Cineplex argued it was owed $1.32-billion – the difference between the per-share deal price and Cineplex's share price after Cineworld backed out. This is commonly referred to as "lost shareholder premium" or the "benefit of the bargain." But the court rejected this approach, deciding instead that Cineplex should receive the "lost synergies" of the deal.

When you sell your house, you sign the agreement directly with the buyer. Things work differently in public M&A: The target public company, not the company's owners – i.e., its shareholders – signs the contract with the buyer. Put another way, it's the house, not the homeowner, signing the contract with the buyer.

So the court's logic was essentially that the company could not sue the delinquent buyer for damages suffered by the shareholders (i.e., lost shareholder premium); it could only sue the delinquent buyer for damages suffered by the company, in this case for the synergies the company would have enjoyed had the deal closed (and had the two media and entertainment companies combined their operations as planned).

On a strictly legal level, this arguably makes sense. But on a practical level, it does not, as what was bargained for but effectively lost was the shareholder premium.

U.S. dealmakers had long wrestled with the same problem, and for two decades the solution was contractual clauses expressly allowing the company to claim against a delinquent buyer for the lost shareholder premium. But in late 2023, in a lawsuit arising from Elon Musk's acquisition of Twitter (now known as X), the Delaware Court held that these clauses were unenforceable.

As Delaware law is chosen for many (if not most) high-value U.S. M&A transactions, U.S. lawyers were thrown into a minor panic. Twenty years of market practice had been abruptly overturned, and the fear immediately became that buyers could become more likely to back out of deals should any buyer's remorse set in between signing and closing. But Delaware lawmakers quickly swooped in, changing the state's corporate law in August, 2024, to permit the lost shareholder premium clauses the court had struck down.

Canadian federal and provincial lawmakers should follow suit. The issue is not merely theoretical: Significant investor returns are potentially at stake. In the Cineplex dispute, the difference between the lost shareholder premium of $1.32-billion claimed and the lost synergies of $1.24-billion awarded was $80-million. But the difference could easily have been much more, and multiple Canadian academics have raised red flags around this. They point out that calculating lost synergies is inherently complicated, unreliable, unpredictable and can vary widely depending on the nature of the buyer, many of whom (e.g., a financial buyer) may not bring any synergies to the table.

Should any "synergy-less" buyer illegitimately back out of acquiring a Canadian public company, it will be the company's investors who will lose. And the risk is arguably growing. Turbulent economic times can bring great swings in stock value, and when this occurs between signing and closing, it can leave a buyer looking for the door. Delaware has shown that a relatively simple fix is possible. Why not protect investors in Canadian public companies by following its lead?

https://www.theglobeandmail.com/business/commentary/article-publicly-traded-companies-need-more-recourse-when-mergers-fall-through/