Message to Potash Corp: Poison pills taste bad

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Rising earnings and dividends are all very nice, but most investors would probably ditch such long-term expectations for the thrill of a takeover offer. With a hefty premium, double-digit gains are yours for the taking - unless, that is, management gets in the way.

Potash Corp. of Saskatchewan did just that on Tuesday, making it virtually impossible for BHP Billiton Ltd. to buy the fertilizer producer - for now, at least - by changing the rules. If a shareholder takes a 20-per-cent stake in the company, existing shareholders would get the right to buy a lot more shares at a discounted price, making a takeover prohibitively expensive.

It's commonly known as a poison pill provision, a sometimes-controversial tactic used to stall a takeover bid or put the kibosh on it altogether. If it seems at odds with the concept of free markets and shareholder interests, it often is.

"It's really whether a board uses a rights plan as a tool or as a weapon," said Patrick McGurn, special counsel for Institutional Shareholder Services. "In the hands of the right board, sometimes it's a great way of having some time for the board to conduct an auction of the company; to get some breathing room."

In the wrong hands, though, shareholders can get burned. Just ask anyone who held on to Yahoo shares in 2008 when Microsoft made a $44.6-billion (U.S.) offer for the company. Yahoo shares rose 48 per cent the day the offer was made public, but management erected obstacles and the deal fell through. Shares have since fallen by more than 50 per cent.

Japan offers a similar cautionary tale. Firms there issued a rash of longer-term poison pill provisions earlier in the decade to thwart takeovers. The deterrent worked too well: It has been blamed for low foreign interest in Japanese stocks.

In the case of Potash Corp., the hope among investors is that it will be able to get a better offer from BHP Billiton or another firm. The track record for poison pills of this sort is mixed, but it might work.

Fairmont Hotels & Resorts Inc. represents the hope. The hotel chain introduced a poison pill after Carl Icahn offered $40 a share for the company in 2005. With the delay, Fairmont managed to attract a $45-a-share offer from Saudi Prince al-Waleed bin Talal.

"We understand why they're put in place," said Wayne Kozun, senior vice-president of public equities at Ontario Teachers' Pension Plan. "Sometimes an offer can come out of the blue and you have a very limited amount of time to respond. So it gives the company some time to put something else together."

According to Lucian Bebchuk, professor of law, economics and finance at Harvard Law School, a problem arises however when they are used as more than a stalling tactic.

"From the perspective of shareholders and good corporate governance, it is undesirable to allow the use of poison pills to just say 'no' indefinitely to an offer," he said in an e-mail.

That's harder to do in Canada than it is in the U.S., but that's not to say some companies here haven't tried to stall and stall, and stall again. And, isn't there a better way?

As the Asian Corporate Governance Association put it in a 2008 white paper on corporate governance, "the best defence against a hostile takeover is not a poison pill, but a strong share price resulting from disciplined financial management ... a sound business and investment strategy ... and a management team that has the trust of shareholders."

In other words, good companies don't need to use poison.