Shareholder Activism in Canada: The Legal Framework

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Overview

Shareholder activism is now firmly entrenched in the Canadian corporate landscape, and Canada has proven fertile ground for dissidents. This guide provides a brief overview of key tactics and related legal considerations fundamental to shareholder activism in Canada. We first consider the tactics available to an activist under Canadian law. We then consider potential target responses and how an activist may counter such defensive tactics. We conclude with certain additional legal issues for activists and targets to consider.

Offensive Tactics Available to Activists

Often characterized as "activist friendly", Canadian law affords several key avenues of attack for dissident campaigns.

- Stakebuilding: Activists can acquire up to a 9.9% shareholding without being required to make any public disclosure. Once a 10% stake is accumulated, however, a press release must be immediately issued and an "early warning report" must be filed within 2 business days (unless the activist is an "eligible institutional investor" that is not disqualified from using the alternative monthly reporting system). The mere formation of a group (e.g. an activist and its "joint actors") holding 10% or more will not trigger early warning reporting requirements; however, absent an exemption, the acquisition of a single share by any group member will trigger early warning reporting requirements. The formation of a group would also trigger a filing obligation if it is a change in material fact in a previously filed report. Among other things, early warning reports require the activist to disclose its identity, ownership position and investment intent. Canada's takeover bid regime is triggered once an activist acquires a shareholding of 20% or more. Significantly, this includes an obligation to make an offer to all shareholders of the target in compliance with the pre-bid integration requirements.

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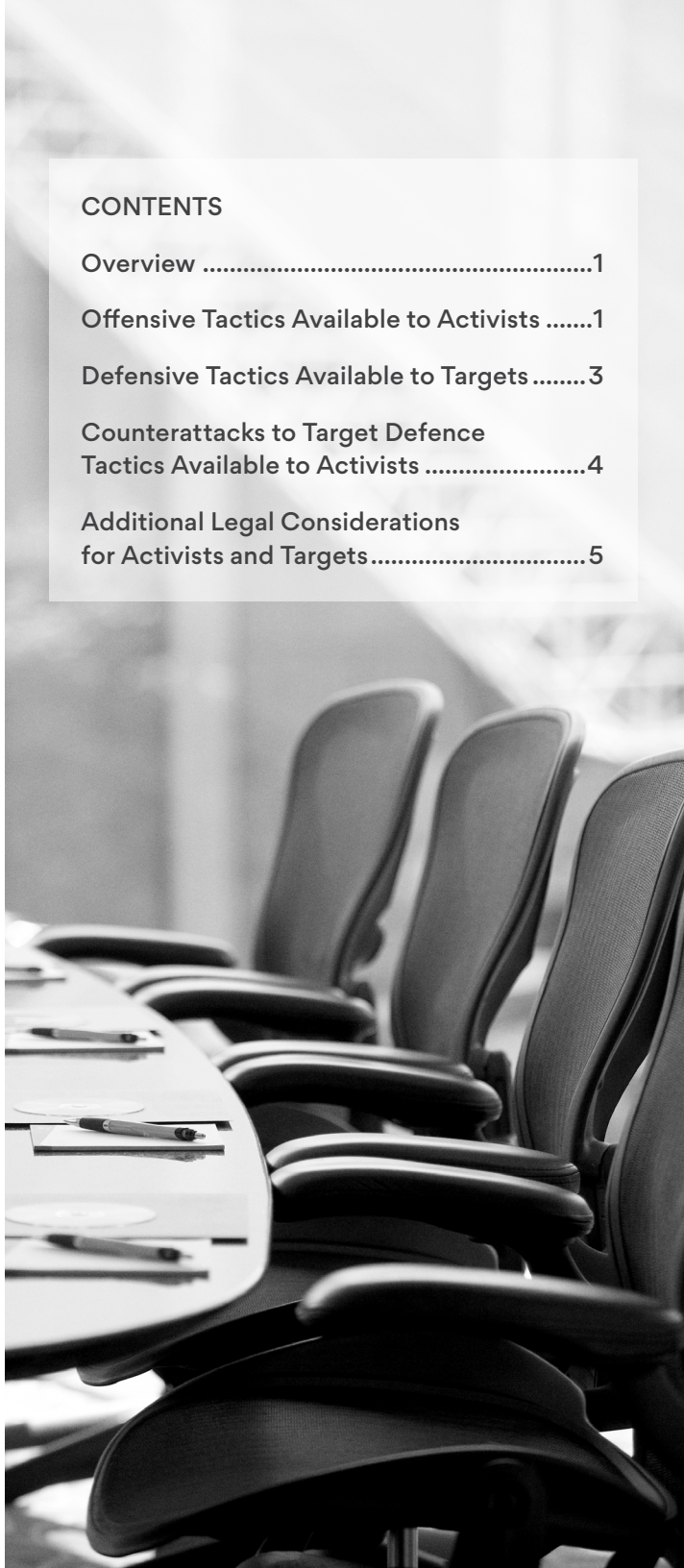

- Shareholder Proposals: Canadian corporate law accommodates "activism-lite" via a shareholder proposal. Specifically, a dissident owning as little as a 1% shareholding is entitled to have included in a target's proxy circular a paragraph of not more than 500 words advocating its cause. That said, where the proposal relates to the election of directors a minimum 5% shareholding is needed.
- Majority Voting: "Vote No" and "Withhold the Vote" campaigns are generally both easier and less costly to wage than proxy contests, and this holds true in Canada. However, Canadian law in the form of majority voting under the TSX Rules and certain corporate statutes also facilitate such campaigns by requiring that a director immediately resign where the director does not receive a majority of votes in an uncontested election.
- Meeting Requisition: Upon accumulating a 5% shareholding an activist is entitled to requisition a shareholder meeting. The mere existence of this right is a significant source of leverage. The requisition notice must give sufficient information regarding the proposed business to be discussed. Furthermore, given target-friendly caselaw, the exercise of this right necessitates careful planning and compliance with technical requirements.
- White Papers: Many activists find benefit in producing a "white paper" prior to launching their campaign. These are based on publicly available information on the target that is required to be disclosed under applicable securities laws. White papers often present a "case for change" in support of the activist's agenda and can be key in winning support from other shareholders and/or proxy advisory firms. They can also be of great value in private discussions with management (and not only should a proxy battle eventuate).
- Quiet Solicitation: In most jurisdictions, exemptions permit activists to solicit proxies from up to 15 shareholders without mailing a dissident proxy circular. This allows for a degree of stealth, including as small numbers of institutional investors often hold large blocks of shares in Canadian public issuers. That said, as discussed below, complex laws regarding "joint actors", "insider trading" and "tipping" – to which institutional investors are typically highly sensitive – need to be carefully navigated.
- Public Broadcast: An alternative to mailing a dissident proxy circular is proceeding by public broadcast, which can be by press release, advertisement or other notice generally available to the public. This allows the activist to avoid the time and costs associated with a circular (although certain information required in a circular must still be filed as part of the broadcast). This also provides an activist the opportunity for a loud opening salvo, including control over the initial campaign narrative. However, an activist should be mindful that using the public broadcast exemption does not thereafter give it the right to engage in private meetings with shareholders.
- Dissident Proxy Circular: Should an activist wish to move beyond quiet solicitation and/or a public broadcast, the mailing of a dissident proxy circular is facilitated by each shareholder being entitled to a list of all other registered shareholders. Such a request will, however, alert the target to the activist if this has not already occurred. Often, but not always, an activist will wait to mail its circular until after the target's circular to take issue with or criticize aspects thereof. In some cases, activists have prepared "pre-emptive" dissident circulars that are provided to shareholders prior to the record date to facilitate meetings beyond what would be allowed under the quiet solicitation exemption.
- Proxy Advisor Support: Proxy advisory firms can have crucial influence over shareholder voting, as institutional investors often follow their recommendation and retail shareholders may be influenced as well. Winning proxy advisor support can be achieved by presenting a compelling case for change and, where necessary, effectively communicating a well-reasoned and persuasive business plan to them.

Defensive Tactics Available to Targets

Targets benefit from structural defensive measures as well as other tactics available in defence of an activist attack.

- Advance Notice Bylaws: Over the past decade high-profile activist campaigns have prompted most public companies to adopt advance notice bylaws (ANBs). These typically require (1) at least 30 days advance notice of an activist nomination, (2) the identity, age and residency of nominees, and (3) details of any arrangements between nominees and the activist. Certain disclosure by the activist is also typically required, including (1) its other economic or voting interests, including derivatives, and (2) proxies collected and any other ability to vote shares.
- Shareholder Rights Plans: Many Canadian public issuers have adopted shareholder rights plans (SRPs). While the utility of such plans in the context of hostile bids diminished markedly with the overhaul of Canada's takeover bid regime in 2016, they continue to negate the availability of two important exemptions to the takeover bid rules, being the "Private Agreement" exemption and the "Normal Course Purchase" exemption. In addition, some companies have adopted "voting pills" which expand the circumstances in which a SRP is triggered by capturing proxy solicitation activity and agreements among shareholders to vote together, thereby hindering efforts by shareholders to use their collective voting power to control the issuer.
- Opposing Meeting Requisitions: Several courts have interpreted Canadian corporate statutes narrowly and technically to foil activist meeting requisitions. This has made target attempts to invalidate requisitions somewhat common. Other courts have shown considerable deference to boards regarding the timing of requisitioned meetings. The end result here is that many boards have been permitted to delay a requisitioned meeting until the company's next-scheduled AGM and in one case for more than 150 days. That said, recent caselaw emphasizes the importance of the process a board adopts in responding to a meeting requisition: if the board does not give sufficient consideration to the specific requisition in the specific circumstances at hand, the board's deliberations may be deemed undeserving of the court's deference.
- Complaints to Securities Regulators: Another common target reaction to a dissident campaign is alleged noncompliance by the activist with securities legislation, such as regarding (1) disclosure requirements related to shareholding, (2) prohibitions against insider trading or tipping, (3) share accumulation triggers resulting from alleged "joint actors", (4) compliance with proxy solicitation rules, and/or (5) alleged material public misstatements.
- Tactical Private Placements / Share Repurchases: Several companies have attempted tactical private placements amid proxy contests and to mixed results before authorities. Alternatively, companies have engaged in distributions of cash or significant non-cash assets to shareholders via issuer bids, special dividends or spin-offs. In either case, it is important for the target to be able to demonstrate that it had a valid business reason for the transaction.

Counterattacks to Target Defence Tactics Available to Activists

Canadian law allows for numerous potential activist counterattacks to the foregoing target defensive tactics.

- Challenging ANBs: Activists have been successful in challenging a target's invocation of ANBs amidst a proxy contest. Towards this end the courts have held that ANBs should operate as a "shield" to protect against "ambush" and not as a "sword" designed to exclude nominations given on reasonable notice or to buy excess time to attempt to thwart a dissident campaign. So too have courts held that any ambiguity in the drafting of ANBs should be resolved in favour of shareholders' voting rights.
- Challenging SRPs: Proxy contests in Canada include several examples of regulators cease trading SRPs put in place by targets. In so doing, a key principle invoked by regulators and courts has been protecting the opportunity of shareholders to exercise their rights as such. Regulators have also indicated that SRPs should generally not be utilized to deem a shareholder to beneficially own shares subject to a lock-up agreement "in circumstances where they would not be deemed joint actors under the applicable rules." In addition, proxy advisors have made it clear that they would generally recommend voting against the approval of voting pills, and it is expected that securities regulators would intervene to cease-trade voting pills out of public interest concerns that they are abusive of shareholders' rights.
- Shareholder-Called Meeting: Where a 5% activist requisitions a meeting, the target's board is required to call the meeting within 21 days of receipt of the requisition. If the target's board refuses to call the meeting or selects a date involving "unreasonable" delay, the activist can seek a court order forcing an earlier date. Moreover, if the board doesn't call the meeting within 21 days of the requisition, the activist can call the meeting directly. In such circumstances the activist will also be entitled to be reimbursed for reasonable costs incurred in calling and holding the meeting.
- Invalidation of Private Placement: Numerous dissident shareholders have successfully opposed tactical private placements before securities regulators. In one case an issuance of voting securities after the dissident had requisitioned a shareholder meeting led to undertakings to the Ontario Securities Commission (OSC) that the issuer could and would unwind the private placement in the event the activist's application to the OSC was successful. In another case the TSX's conditional approval of the issuance of equity for existing debt was set aside pending a meeting of shareholders to either ratify the issuance or instruct the board to reverse the issuance.
- Oppression Remedy: A powerful and versatile weapon in an activist's arsenal in Canada is an oppression claim. A creature of statute, oppression protects against corporate or director conduct that is unfairly prejudicial to one or more shareholders. Moreover, available remedies include restraint of the oppressive conduct, setting aside a transaction, or even the removal or replacement of directors. For example, oppression claims have been brought in pursuit of (1) appointing an independent chair for a shareholder meeting, (2) limiting commercial acts a target can engage in prior to the meeting, and (3) compelling additional target disclosure.

Additional Legal Considerations for Activists and Targets

Select additional legal considerations for activists and targets include the following.

- Ongoing Reporting: Upon attaining a 10% shareholding an activist assumes ongoing reporting obligations. These include disclosure of (1) each time the activist acquires or disposes 2% or more of the subject securities, (2) if the activist falls below the 10% threshold, and/or (3) a material change in information within a previously filed report.
- Insider Trading, Tipping and "Joint Actors":
  - *Insider Trading:* Trading with knowledge of material non-public information (MNPI) is prohibited. This includes MNPI that an activist learns in private discussions with a target. However, the fact an activist is considering campaigning to replace target directors generally does not, in and of itself, prohibit the activist from acquiring target shares.
  - *Tipping:* Disclosing to others MNPI that an activist has learned from the target is prohibited. Disclosing to others an intention to pursue a proxy contest is generally not prohibited. However, care should be taken if the activist owns 10% or more target shares since at that point the activist would be considered to be in a "special relationship" with the target.
  - *"Joint Actors":* If an activist has an agreement, commitment or understanding with one or more other persons and intends to exercise voting rights in concert with such other persons, they are *presumed* to be "joint actors". If the agreement, commitment or understanding is with respect to the acquisition of shares of the target company, they are *deemed* to be "joint actors". Importantly, the shareholdings of "joint actors" are aggregated for purposes of the 10% and 20% thresholds discussed above.
- Derivatives: At present, swaps generally do not count toward determining whether the 10% or 20% thresholds have been reached. However, they may count where the activist has either a legal right to control or direct the voting of swap shares or a contractual right to influence voting decisions regarding swap shares. Moreover, regulators have held inadequate disclosure of swap holdings – such as in the context of a takeover bid – as failure to comply with securities laws and even "abusive". To the extent that early warning reporting is required, disclosure is required in respect of "related financial instruments", which are agreements, arrangements or understandings that affect the economic interest or exposure to the issuer.

- Soliciting Dealer Fees: Although soliciting dealer fees are technically not illegal in Canada, the practice is not risk free. Any such arrangement must be disclosed in a dissident's and/or target's proxy circular. Significant reputational consequences may also ensue, as illustrated by previous high-profile proxy battles and given certain market disfavour toward such strategies. Related regulations also come into play, including of the Investment Industry Regulatory Organization of Canada (IIROC).
- Protocol Agreements: Activists can attempt to persuade a target to enter a protocol agreement establishing meeting mechanics, including the ability to review proxies and the procedure for accepting proxies. The reality, however, it that the target has no legal obligation to accede to a protocol agreement, and so such attempts are often rebuffed. Nor is the target under any duty to disclose any voting results before their announcement at a meeting.
- Independent Chair: Canadian courts would not be expected to appoint an independent chair based on alleged conflict of interest arising merely from the chairman standing for re-election. Where activists have been successful securing an independent chair, it has generally been based on a more acute conflict or evidence of bias indicating an independent chair is necessary to achieve fairness.
- Settlement Agreements: Targets often recognize that defending against a proxy contest requires the commitment of significant time and resources and will disrupt management's execution on business objectives. As such, opportunities to reach settlement typically arise, sometimes even before the activist campaign becomes public. Alternatively, opportunities for settlement may be delayed and only arise as the anticipated results of the proxy contest become clearer. It is common for settlement agreements in Canada to include board nomination rights, committee representation and reimbursement of expenses. In exchange, activists often accept standstill provisions that prevent the activist from acquiring any additional interest in the target or taking any action to remove directors for a stipulated period of time.

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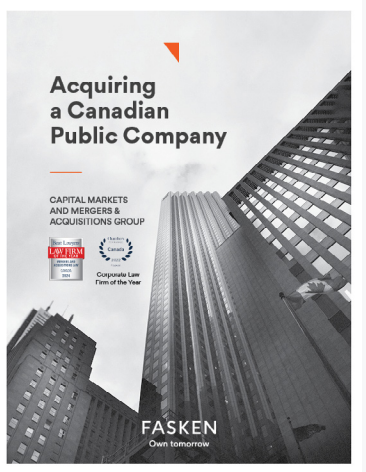

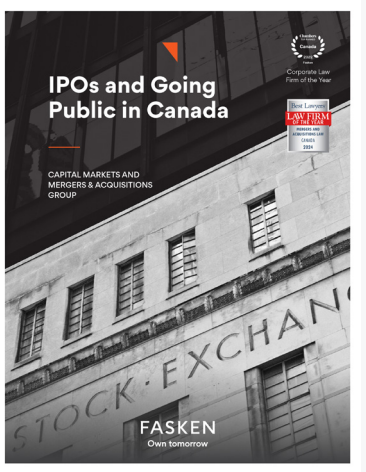

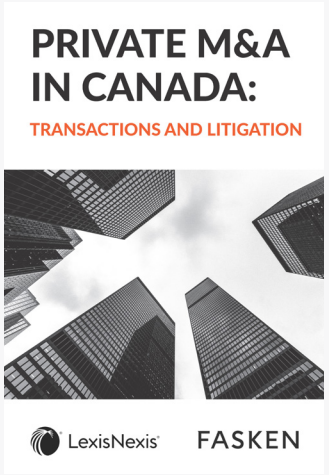

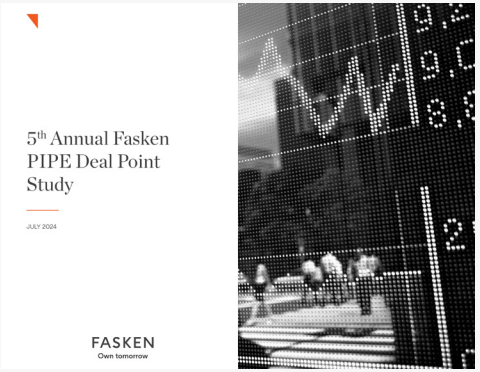

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