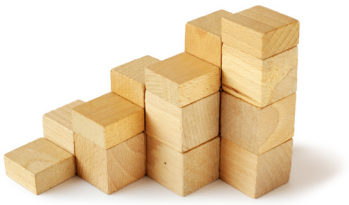
Borden Ladner Gervais

M&A BuildingBlocks

What you need to know before your proxy fight

Sometimes M&A involves dissident shareholders and a proxy contest. This building block focuses on the issues that arise in that context.



Introduction

Shareholder activism occurs when an individual or group of shareholders takes action to bring about change within a public company without purchasing a controlling interest.

No company is too big, too well governed or too profitable to avoid the threat of shareholder activism entirely. Targets have included BHP, Bristol-Myers Squibb, CP Rail, Hyundai, Procter & Gamble, SAP, Sony and many other notable large market capitalization companies.

The number of global shareholder activism initiatives has generally increased steadily year after year, with a brief pullback in 2019 following the record pace set in 2018. To date, the COVID-19 pandemic has had the effect of slightly subduing global shareholder activism, with the number of global shareholder activism campaigns launched in line with those seen in the first half of 2016.

As more certainty emerges about the effects of the pandemic, market participants can expect activists to come out swinging against companies weakened by COVID-19 challenges, with heavy criticism aimed at how management teams have responded to the pandemic.

1 Who are the activists and what is their objective?

Classic activist investors are typically activist oriented hedge funds. However, the universe of activist investors has been growing and institutional investors (including index funds), Environmental, Social and Governance (ESG) investors and disgruntled former executives have all instituted activist campaigns in Canada.

An activist will often say their actions are in the interests of:

- **improving corporate governance** (*e.g.* enhancing board independence; separating the CEO and the Chair of the Board; enhancing Board diversity; replacing longer-tenured or "over boarded" directors; or paring back executive compensation); or
- **advancing ESG interests** (*e.g.* reducing impacts on climate change, improving environmental practices and sustainability, addressing discrimination, defending human rights and/or fair labour practices, defending animal welfare, addressing corporate political spending).

These practices assist with procuring support from other shareholders. With few exceptions, however, the true objective of most activists is to advance an investment strategy.

Some activists are more transparent than others regarding their intention to impact shareholder value. This is particularly the case for hedge funds, which often put forward a competing investment hypothesis focused on creating change that may differ radically from management's current business plan. These types of shareholder activists often submit that shareholder value will be maximized by changing management, pursuing (or not pursuing) a significant transaction, or altering corporate strategy.

2 What is a proxy fight?

A proxy fight is a subset of shareholder activism whereby one or more activists compete with management of a corporation for proxy votes from shareholders in connection with a shareholders' meeting, usually in the context of the election of directors. This article provides a number of key considerations relevant to participants engaging in a proxy fight.

3 How much does it cost?

Proxy fights are expensive. In Canada, reports of 2019 proxy fight costs ranged from $350,000 to $20,000,000. Proxy fights in the United States can be even more expensive with Procter & Gamble estimating its 2017 proxy fight cost as US$100 million.

In a significant Canadian proxy fight, each of the activist and the target will often engage, among others:

- One or more sets of legal counsel;
- A proxy solicitation firm;
- A communications advisor;
- An investment bank;
- A governmental relations firm; and
- A private investigation firm.

As a result, particularly for activist investors looking to take the initiative in launching a proxy fight, a realistic estimate of the potential costs should be obtained and a cost–benefit analysis undertaken when deciding whether to initiate a fight and in formulating the strategy to be used.

4 How does the fight begin?

To launch a proxy fight, an activist typically will either:

- Submit director nominees for consideration at a company's annual shareholder meeting (or initiate a "withhold the vote" campaign for the company's incumbent Board members); or
- Requisition a shareholder meeting for electing its nominees (and, often, removing current Board members).

Generally, holders of no less than 5 per cent of a company's shares may requisition a shareholder meeting in Canada. This means that the activist will have either to acquire at least 5 per cent of the target's outstanding shares or procure support from shareholders for a total support position of at least 5 per cent of the target's outstanding shares.

Often (but not always, especially if the activist is looking to catch the company off-guard), an activist will engage with the company first to determine if it can accomplish its goals without initiating a proxy fight.

5 How does the fight end?

Proxy fights typically end in one of two ways:

- the activist and the target company agree to a negotiated settlement; or
- the matter is taken to a shareholder vote at a shareholder meeting.

While Canadian proxy fights have often ended with a shareholder vote, the trend in Canadian proxy fights is moving toward more negotiated settlements.

6 Proxy fight strategy – timing

A proxy fight will typically last between a few weeks, where a negotiated settlement is reached quickly, to over a year if there are delays in holding a shareholder meeting.

An activist will typically push for a short proxy fight as:

- The activist is generally paying out of pocket and a quicker fight is less expensive;
- The activist is presumably more prepared than the target company; and
- The activist has likely chosen an opportune time to launch the fight.

The target company, by contrast, will typically look to draw out a proxy fight as:

- The company can use company funds to defend itself and a longer proxy fight may deplete an activist's war chest;
- The company may require sufficient time to prepare; and
- The company may need time to implement changes that may blunt the activist's arguments.

There is generally not a prescribed date when a requisitioned meeting must be held. While activists will push for a meeting to be held as soon as possible, target companies will typically delay holding the meeting, arguing (with support from relevant case law) that sufficient time is required to consider and respond to the activist before the meeting.

If the target company does not call a meeting within 21 days following receipt of a requisition, any requisitioning shareholder may do so. The advantage of being the party to call the meeting is significant as they may choose specifics of the meeting such as location and timing, and will have the power to adjourn the meeting if necessary. This advantage is one that target companies should not squander.

7 Proxy fight strategy – solicitation

In order to win a proxy fight each side must solicit proxies in favour of their position from the company's shareholders. The default solicitation rule in Canada is that issuers and activist shareholders are prohibited from soliciting proxies unless they have sent a Proxy Circular to each shareholder whose proxy is being solicited.

"Solicit" is broadly defined to include "a request to execute or not execute a form of proxy" and "the sending of a form of proxy or other *communication* to a shareholder under circumstances that are reasonably calculated to result in the procurement, withholding or revocation of a proxy."

Two exemptions to the default solicitation rule available to activists are:

1. The broadcast exemption – the default solicitation rule does not apply to a solicitation, other than by or on behalf of management, if:
   - The solicitation is made to the public by broadcast, speech or publication;
   - The solicitor complies with the solicitation laws of the organizing jurisdiction of the company;
   - Certain general information related to the solicitor and the solicitation has been filed and included in the broadcast; and
   - The solicitor has previously filed certain information related to its proposed nominees.
2. Solicitation to fifteen or fewer shareholders – under Canadian securities laws and most corporate statutes, the default solicitation rule does not apply to a solicitation, other than by or on behalf of management, if the total number of holders being solicited is not more than 15.

By contrast, there are no true "solicitation exemptions" for companies, although Canadian courts have granted companies some latitude to respond to an activist prior to filing the company's proxy circular. This means that companies are at a distinct communication disadvantage at the outset of a proxy fight and the company's biggest milestone is releasing its proxy fight circular.

In their respective proxy fight circular, each of the activist and the company sets out their case as forcefully as possible in an effort to obtain shareholder support. Given the nature of these fights, the arguments in proxy fight circulars can become personal. As a consequence, allegations of, and actions for, slander and defamation related to proxy fights are routine in Canada.

8 Proxy fight strategy – meeting procedures

As the shareholder meeting nears, the activist will often send the company a request to agree upon meeting procedures. Such procedures will include an independent chair, the opportunity to review proxies and the protocol to accept proxies. The request is designed to sound reasonable, but is frequently denied by the company, primarily because the company will seek to control the process as much as possible. When requests are not granted, activists often apply to the court for relief.

The appointment of an independent chair can generate significant controversy. Courts in Alberta have recently held that the appointment of an independent chair is warranted where it is in the company's best interests to avoid bias or the appearance of it. Courts in B.C. and Ontario, however, have shown less propensity to interfere in a target company's procedure for selecting a chair if there is no evidence of potential impropriety at the meeting.

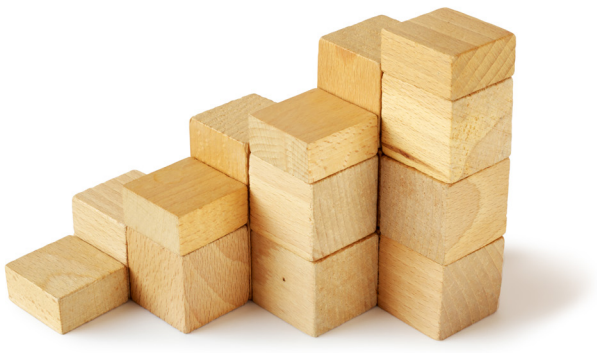
The selection of meeting chair is crucial in proxy fights, as the chair typically has final decision-making authority to determine which proxies count. Such determinations have proved to be pivotal in many proxy contests.

Given the importance of chair selection, a target company and its proposed chair must be especially careful not to give any suggestion of impropriety that would provide a court with a basis for interfering in the company's selection. By contrast, an activist will want to take whatever steps it can to demonstrate potential impropriety to a court to ensure the target cannot select a chair that favours the incumbent Board.

Conclusion

Naturally, there is more strategy involved in a proxy fight that is beyond the scope of this article. If you are an activist looking to launch a proxy fight or a target looking to defend against one, we would be pleased to assist you. Our recent mandates include:

- Acting for Mittleman Brothers LLC in connection with its successful proxy campaign against Aimia Inc., resulting in the replacement of six of eight Aimia board members;
- Acting for Glance Technologies Inc. (now Perk Labs Inc.) in connection with its successful defence of a proxy fight launched by its former President;
- Acting for Guyana Goldfields Inc. in connection with its successful defence of a proxy fight launched by its former Executive Chairman;
- Acting for Aurinia Pharmaceuticals in connection with its successful defence of a proxy fight launched by its largest shareholder;
- Acting for the CEO and Founder of Payfirma Corporation in his successful proxy fight to remove three directors from the Payfirma board; and
- Acting for the Special Committee of Taseko Mines Limited in connection with its successful proxy fight against a shareholder activist.



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