Goodmans LLP

Activist Investing in Canadian Companies

Canada – like other jurisdictions – has continued to see a significant amount of shareholder activism. This is partly due to a growing recognition on the part of activist investors – particularly those outside of Canada – that Canada is a more "activist friendly" jurisdiction than some others, including the United States. Various Canadian corporate and securities laws enable shareholders to effect corporate change with relative ease through shareholder proposals, the requisitioning of shareholder meetings, proxy contests and in some cases through the courts. This summary describes some of the key legal considerations relevant to shareholder activism in Canada.

Accumulating a Position

Canadian Take-Over Laws Accommodate Accumulations of Meaningful Shareholdings

- Any offer to acquire any outstanding voting or equity securities of any class that would result in the investor (and its joint actors) owning 20% or more of that class of securities must be made by way of a formal take-over bid (tender offer) unless an exemption is available.
- In other words, an investor can acquire up to 19.9% of the outstanding shares of a Canadian public company without having to make a formal bid.
- There are a number exemptions from the formal bid requirements. The "private agreement" exemption allows an investor to acquire 20%+ of the outstanding shares without making a formal bid provided the shares are acquired through private agreements with not more than five shareholders and at a price, including brokerage fees or commissions, not exceeding 115% of the market price.

Poison Pills in Canada Are of Less Significance than in the United States

- Poison pills are generally accepted in Canada and until recently, were commonly employed in response to unsolicited takeover bids. However, unlike in the United States, **poison pills in Canada, have not been used to "just say no"** to an unsolicited offer.
- Poison pills are also used as a day-to-day protection against "creeping" take-over bids – i.e., preventing shareholders from using the private agreement exemption (or other exemptions from the formal bid requirements) to acquire more than 20% of the outstanding shares without making a formal bid to all shareholders.
- Canadian securities regulators have adopted new rules to the take-over bid regime whereby, among other things, (i) all bids must remain open for a period of at least 105 days unless abridged by the target board, (ii) at least 50% of all outstanding target shares (other than those held by the bidder) must be tendered before a bidder can take up any securities under the bid and, (iii) if the majority tender condition is satisfied, the bid must be extended for an extra 10 days to allow additional "follow on" tenders. As a result of these new rules, there will generally no longer be any need for target companies to use poison pills in response to a hostile bid.

Reporting Obligations

Early Warning Reporting is Not Required Until the 10% Threshold Has Been Reached

- Canada has an "early warning" disclosure system that is similar to 13D reporting requirements in the United States.
- However, in contrast to the 13D regime, reporting is not required until the acquisition of ownership or control (individually or with joint actors) of 10% or more of the outstanding equity securities of any class on a partially diluted basis (reduced to 5% when a take-over bid is in progress).
- Upon reaching the 10% threshold, an investor is required to immediately issue a press release disclosing, among other things, its identity, ownership position and investment intent and an "early warning report" containing similar information must be filed with Canadian securities regulators within two business days.
- Additional reporting is required each time, (i) the investor acquires or disposes of another 2% or more of the relevant securities, (ii) if the investment falls below the 10% reporting threshold or (iii) if there is any material change in information contained in a previously filed report (e.g., a material change in investment intent).
- Once a reporting obligation has been triggered, the investor must refrain from purchasing additional securities until at least one business day after the filing of the early warning report. This cooling off period does not apply if the investor owns more than 20%.
- There is an alternative monthly reporting system that is available to "eligible institutional investors" (including investment managers that are registered under the U.S. Investment Advisers Act of 1940 or are exempt from registration) that do not (i) make or intend to make a take-over bid for an issuer or to propose a business combination transaction that would give the investor effective control over the issuer or (ii) solicit proxies under certain circumstances.
- The alternative monthly reporting system reduces reporting requirements: (i) press releases are not required; (ii) reporting is done on a delayed basis (10 days after the end of the month in which a reporting threshold is crossed as opposed to immediately after crossing the threshold); (iii) after the 10% threshold, reporting thresholds are in increments of factors of 2.5% instead of 2% and (iv) the investor is exempt from the one business day moratorium on further acquisitions.
- Derivatives and other arrangements that affect an investor's economic interest in the issuer do not independently trigger early warning reporting requirements and are generally not required to be disclosed in an early warning report except for a report filed under the alternative monthly reporting system.

Insider Reporting

- All insiders of an issuer (including 10% shareholders, and their directors and executive officers calculated on a partially diluted basis) must publicly disclose each trade of securities of the issuer by filing an "insider report" within ten calendar days of the initial trade and then within five calendar days of any subsequent trade.
- Insider reports must disclose interests in derivatives and other arrangements that affect an investor's economic interest in the issuer.

Insiders who are reporting for early warning purposes under the alternative monthly reporting system are generally not required to file insider reports.

Other Regulatory Considerations

- The acquisition of 20%+ of the voting shares of a public company could trigger merger notification/review requirements under the *Competition Act* (Canada).
- The acquisition of 33.3%+ of the voting shares of a public company that carries on a business in Canada by a non-Canadian could trigger notification/review requirements under the *Investment Canada Act.*
- Companies operating in certain regulated industries (e.g., telecommunications, broadcasting and insurance) are subject to statutory limits on foreign ownership.

Proxy Solicitation

Activists Have Considerable Opportunities to Communicate

- Dissidents may generally not solicit proxies from shareholders unless they have mailed a dissident proxy circular in the prescribed form to each shareholder whose proxy is being solicited.
- "Solicit" includes, among other things, "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."
- The requirement to mail a dissident proxy circular does not apply (i) where the solicitation is limited to 15 or fewer shareholders or (ii) if the solicitation is conveyed by public broadcast, speech or publication and where the solicitation contains certain prescribed information.

Activists Can Requisition Meetings

- The holders of not less than 5% of the issued voting shares have the right to requisition the directors to call a meeting of the company's shareholders for the purposes stated in the requisition, which can include the removal of any or all of the directors and the nomination of replacements. Shareholders' ability to replace all directors at any shareholder meeting makes staggered boards ineffective.
- The target board of directors will generally be required to call a shareholder meeting in response to a valid requisition within 21 days of receiving the requisition but (other than under BC law, which requires that a requisitioned meeting be held within four months of the requisition) there are no specific legislative requirements as to when the requisitioned meeting must occur.
- If the target board refuses to call the meeting or picks a meeting date that involves an unreasonable delay, the requisitioning shareholder may apply to court for an order calling the meeting or forcing the meeting to be held at an earlier date.

The Proxy Solicitation Process

- There are no rules that specify when a dissident proxy circular must be mailed, but no proxy solicitation can occur prior to mailing, subject to the exceptions noted above.
- Dissident shareholders have the right to obtain a list of registered shareholders from the company for the purposes of mailing the dissident proxy circular and also have the right to distribute the dissident proxy circular to beneficial shareholders through intermediaries.
- As long as disclosed in a circular there are no prohibitions on a dissident's (or the company's) right to pay solicitation fees in an effort to encourage shareholders to deliver proxies. Although this strategy will often face significant negative scrutiny in a hotly contested proxy fight.
- Shareholders are entitled to a form of proxy access – subject to certain requirements, shareholders may submit "proposals" regarding certain matters (including proposals to (i) amend or repeal a by-law; (ii) amend the articles and (iii) nominate directors) for inclusion in management's proxy materials.

Proxy Advisors and Governance Organizations Are Active in Canada

- Proxy advisory firms (e.g., ISS, Glass Lewis) are well established in Canada and frequently play an important role in determining the outcome of shareholder votes.
- In the context of contested meetings, proxy advisors will consider input from the company and the dissident before making a recommendation, but will not provide either side with an opportunity to review or comment on a recommendation before it is released.
- Canadian securities regulators have published a proposal to regulate proxy advisory firms. It is not clear whether or when this proposal will be adopted.

Voting

- Majority voting and voting on a director-by-director basis has become more common with the TSX mandating individual voting in director elections and requiring TSX-listed issuers to adopt majority voting policies.
- Companies are increasingly adopting advance notice by-laws or policies to mitigate the risk of a dissident "ambush" at a shareholder meeting. Proxy advisory firms now have specific guidelines regarding acceptable terms of advance notice by-laws.
- There are no legal requirements for the issuer to give a dissident access to proxy voting results or to review management proxies in advance of the meeting. As a result, it is often difficult for dissidents to have a clear picture of the voting results before they are announced at the meeting.

Reimbursement of Dissident Expenses

- There are no prohibitions on the reimbursement of a dissident's proxy expenses by a target company. If a dissident is successful, this is typically a matter that is addressed as part of a settlement with the outgoing or reconstituted board once the proxy contest is over.

About Goodmans

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