Jon Feldman
Michael Partridge
Goodmans LLP

Activist Investing in Canadian Companies

Since 2007, Canada – like other jurisdictions – has seen a significant increase in shareholder activism. This increase can be attributed in part to underperformance by many of the companies who have been targeted. At the same time, there is 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. Canadian corporate and securities laws enable shareholders to relatively easily effect corporate change through shareholder proposals, the requisitioning of shareholder meetings, proxy contests and in some cases through the courts. This article provides an overview of some of the key legal considerations relevant to shareholder activism in Canada.

Accumulating a Position

Canadian Take-over Bid Rules Accommodate Accumulations of Meaningful Positions

Under Canadian securities laws, a "take-over bid" occurs when an offeror offers to acquire equity or voting securities that, when aggregated with the offeror's holdings (and those of persons or companies acting jointly or in concert with the offeror), constitute 20 per cent or more of the class of securities of the target for which the offer is made. If an acquisition of the target's shares triggers the take-over bid rules, the acquiror must make the same offer to all of the target's shareholders by way of a formal take-over bid circular unless an exemption is available.

There are a number of exemptions from the formal take-over bid requirements, including:

- acquiring shares through private agreements with not more than five shareholders, provided the consideration paid, including brokerage fees or commissions, does not exceed 115 per cent of the "market price" of the shares; and
- normal course purchases of not more than 5 per cent of a class of securities of the target at prevailing market prices over a 12-month period.

These exemptions are frequently used by activist investors who wish to acquire positions in excess of 20 per cent without having to make a formal take-over bid.

Poison Pills in Canada are Less Potent than in the United States

Just as in the United States, shareholder rights plans or "poison pills" are a widely accepted part of the Canadian corporate landscape and are commonly employed:

- in response to an unsolicited take-over bid; and
- as day-to-day protection against shareholders taking advantage of "gaps" in Canadian securities laws, such as the take-over bid exemptions described above, to accumulate more than 20 per cent of a company's shares without making a formal take-over bid to all shareholders (a tactic that is sometimes referred to as a "creeping" take-over bid).

Canadian poison pills are, however, less potent than their American cousins and therefore present less of an obstacle to unsolicited control transactions. This is partly because Canadian poison pills almost always allow an unsolicited offer that qualifies as a "permitted bid" to proceed. A "permitted bid" is generally a take-over bid that, among other things, is open for acceptance for at least 60 days and may not be completed unless a majority of the shares held by "minority" shareholders are tendered.

More importantly, poison pills in Canada generally cannot be used to "just say no" to an unsolicited offer. In most cases, Canadian securities regulators will "cease trade" a poison pill (*i.e.*, render it ineffective) once the offer has been outstanding for a sufficient amount of time to allow the target directors to explore alternative transactions — this has traditionally been somewhere in the range of 60 to 90 days after the hostile bid was launched. Accordingly, in Canada a poison pill can typically only delay, and not prevent, an unsolicited offer from proceeding and a determined bidder can be confident that target shareholders will ultimately have an opportunity to accept its offer.

Reporting Obligations

Early Warning Reporting is Not Required Until 10 per cent Ownership

Canada has an "early warning" disclosure regime that is similar to 13D reporting requirements in the United States. However, in contrast to the 13D regime, under the Canadian rules disclosure of an investor's ownership position is not required until it owns or controls (individually or with joint actors) 10 per cent or more of the outstanding equity securities of any class (reduced to 5 per cent when a take-over bid is in progress). This higher reporting threshold allows an activist investor, in many cases, to accumulate a significantly larger stake in a target company before disclosing its interest compared to what would be required in the United States.

Upon reaching the 10 per cent threshold, an investor is required to immediately issue a press release disclosing, among other things, its identity, its ownership position and its investment intent. An "early warning report" containing similar information must be filed with Canadian securities regulators within two business days. Additional reporting is required each time the investor acquires another 2 per cent or more of the relevant securities or if there is a change in any material fact contained in a previously filed report (*e.g.*, a material change in investment intent).

THOMSON REUTERS LEXPERT

Reprinted with permission from *The 2013 Lexpert®/American Lawyer Guide to the Leading 500 Lawyers in Canada* © Thomson Reuters Canada Limited.

An investor who triggers an early warning reporting obligation must also refrain from purchasing additional securities until at least one business day after the applicable early warning report has been filed. This cooling off period does not apply if the investor owns more than 20 per cent of the relevant securities.

Eligible Institutional Investors are Subject to Less Onerous Reporting Obligations

There is an alternative monthly reporting system available to "eligible institutional investors" (including investment managers that are registered under the US Investment *Advisers Act of 1940* or are exempt from registration) that do not 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. Many institutional investors that frequently engage in shareholder activism, such as hedge funds and private equity funds, qualify as eligible institutional investors. Activist intentions that are short of acquisition of control will not generally prevent an eligible institutional investor from using the alternative monthly reporting system.

The alternative monthly reporting system has several advantages over the standard early warning system: (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 per cent threshold, reporting thresholds are in factors of 2.5 per cent instead of 2 per cent increments; and (iv) the investor is exempt from the one business day moratorium on further acquisitions. Accordingly, an activist investor that qualifies to use the alternative monthly reporting system can accumulate a very significant position in a target company (potentially in excess of 20 per cent, if the investor is able to avail itself of one of the exemptions from the formal take-over bid requirements described above) without being required to disclose that position for at least 10 (and potentially as many as 41) days.

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 Reports

In addition to early warning reports, a shareholder who beneficially owns or controls more than 10 per cent of the total outstanding votes of a reporting issuer on a partially diluted basis must publicly disclose each trade of securities by filing an insider report — within 10 calendar days of the initial trade and then within five calendar days of each subsequent trade.

Insider reports must disclose interests in derivatives, but ownership of derivatives will not, in and of itself, trigger an obligation to file insider reports regardless of the size of the economic interest. In other words, an investor that owns no shares and a derivative position representing an economic interest in 15 per cent of the issuer's outstanding shares is not required to file insider reports, but if that investor were to subsequently acquire 10 per cent of the issuer's outstanding shares it would be required to file an insider report disclosing both its actual ownership position and its derivative position.

Eligible institutional investors are exempt from insider reporting requirements, provided they file the reports required under the alternative monthly reporting system and meet certain other conditions, including disclosing any change in derivatives and other arrangements that affect the shareholder's economic interest in the issuer that has a similar economic effect to an increase or decrease in its securityholding percentage in a class of voting or equity securities of the reporting issuer by a factor of 2.5 per cent or more.

Regulatory Considerations

In addition to take-over bid and disclosure requirements, accumulating a significant position in a Canadian company may subject an investor to additional Canadian regulatory restrictions or requirements. For example:

- acquiring 20 per cent+ of the voting shares of a public company could trigger merger notification/review requirements under the *Competition Act* (Canada);
- acquiring 33.3 per cent+ 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 (such as telecommunications, broadcasting, insurance, banking and uranium mining) are subject to statutory limits on ownership; and
- certain Canadian tax credits or other favorable tax treatment are available only to companies that maintain prescribed levels of Canadian ownership.

Investors (particularly non-Canadian investors) should carefully consider and understand all of the regulatory considerations and consequences that may be triggered by a significant investment in a Canadian company before proceeding.

Proxy Solicitation

Activists Have Considerable Opportunities to Communicate with Target Shareholders

Canadian securities and corporate legislation prohibit dissident shareholders from soliciting proxies unless they have first mailed a dissident proxy circular in a prescribed form to each shareholder whose proxy is being solicited. While "solicit" is broadly defined to include, 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**

Reprinted with permission from *The 2013 Lexpert®/American Lawyer Guide to the Leading 500 Lawyers in Canada* © Thomson Reuters Canada Limited.

LEXPERT THOMSON REUTERS

to a shareholder under circumstances that are reasonably calculated to result in the procurement, withholding or revocation of a proxy", not all communications between a dissident and other shareholders will necessarily constitute proxy solicitation. Additionally, there are certain exceptions to the requirement to mail a dissident proxy circular in connection with a proxy solicitation such as:

- the solicitation is limited to 15 or fewer shareholders; or
- the solicitation is conveyed by public broadcast, speech or publication, and contains certain prescribed information.

Accordingly, there are a number of ways that an activist investor can effectively communicate with other shareholders without having to prepare and mail a dissident proxy circular.

Activists Can Requisition Meetings

Holders of not less than 5 per cent of the issued voting shares of a Canadian company generally have the right to requisition the directors to call a meeting of the target shareholders for the purposes stated in the requisition. It is not necessary for a requisition to be made by a single shareholder with a 5 per cent holding, rather shareholders can aggregate their holdings to achieve the 5 per cent requirement. Under many corporate statutes the right to requisition a meeting is held only by **registered** shareholders — in those circumstances to deliver a valid requisition a beneficial shareholder would either have to arrange to (i) have shares re-registered directly in its name or (ii) arrange for the registered shareholder who holds its position directly (typically CDS Clearing and Depository Services Inc.) to act on its behalf.

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 under most Canadian corporate statutes there are no specific requirements as to when the requisitioned meeting must be held. Therefore, when the meeting is actually held will be within the target board's discretion. However, if the target board refuses to call the meeting the requisitioning shareholder will have the right to call the meeting itself and be reimbursed for any expenses it incurs associated with requisitioning, calling and holding the meeting. If, as is more typically the case, the company does agree to call the requisitioned meeting but chooses a meeting date that involves an unreasonable delay, the requisitioning shareholder may apply to court for an order 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 unless an exemption is available, no proxy solicitation can occur prior to mailing. In practice, a dissident shareholder will typically mail its circular shortly after the management circular has been mailed — this gives the dissident a chance to review the management circular and include a response in its circular. Once the dissident circular is mailed, the dissident will typically commence its formal proxy solicitation process.

In order to facilitate the proxy solicitation process, 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 it is 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 brokers and shareholders to deliver proxies. The manner in which proxies will be solicited must be clearly disclosed in the proxy circular, and proxy solicitation techniques that are not consistent with what has been disclosed can be challenged in court. In addition, appropriate safeguards must be put in place to ensure that voting instructions are properly given to shareholders, voting results can be properly verified and shareholders have the ability to revoke their proxies in a timely manner, to mitigate the risk of challenges as to the validity of the proxy solicitation process in court or otherwise.

Notwithstanding the generally favorable conditions for activists, it is worth noting that there are no legal requirements for the company 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. This informational advantage can often be a tactical advantage used by management in the context of potential settlement negotiations.

Finally, there are no prohibitions on the reimbursement of a dissident's proxy expenses by the target company, nor is there any right to such reimbursement. If a dissident is successful, reimbursement is addressed as part of a settlement with the outgoing board or with the reconstituted board once the proxy contest is over.

Activists have Significant Access to the Company's Proxy Process

A dissident, as a registered or beneficial holder of shares entitled to be voted at a meeting of shareholders, may:

- submit notice of any matter that it proposes to raise at a meeting of shareholders (a "proposal"); and
- discuss at the meeting any matter in respect of which it would have been entitled to submit a proposal, including, for example, proposals to amend the company's articles of incorporation or to replace incumbent directors.

The target board is not required to circulate the proposal under certain circumstances, including if (i) the proposal was not submitted within the applicable period prescribed by the corporate statute, (ii) it clearly appears that the primary purpose of the proposal is to enforce

THOMSON REUTERS LEXPERT

Reprinted with permission from *The 2013 Lexpert®/American Lawyer Guide to the Leading 500 Lawyers in Canada* © Thomson Reuters Canada Limited.

a personal claim or redress a personal grievance against the company or its directors, officers or security holders or (iii) it clearly appears that the proposal does not relate in a significant way to the business or affairs of the company.

However, where a proposal is properly submitted and the target company solicits proxies, the proposal must be included in (or attached to) the company's management information circular. While shareholder proposals may only be considered at a meeting duly called by the company, this access to the company's proxy process can provide a convenient mechanism for an activist to seek support for its proposals, one that is considerably less involved (and less expensive) than soliciting proxies under a dissident circular.

Advance Notice Policies and Bylaws on the Rise

Advance notice policies and bylaws require that advance notice be given to a company of shareholder proposals and director nominations. Such policies and bylaws are particularly relevant in Canada, where dissidents historically have had the legal tools available to them to effectively "ambush" a meeting of shareholders and replace some or all of the board of directors, provided they have sufficient votes to do so, by making a motion to nominate replacement directors at a shareholder meeting (without advance notice to the issuer or to its shareholders generally).

Advance notice policies and bylaws have not traditionally been used by Canadian companies but were recently endorsed in a decision by the Supreme Court of British Columbia. This decision, combined with the increasing level of shareholder activism aimed at companies that are particularly prone to "ambush" tactics (such as smaller resource issuers with largely retail shareholder bases) may encourage more boards to start adopting advance notice policies or bylaws in the future.

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. Therefore, preparing a thorough and compelling presentation for the "pre-recommendation" meeting with the proxy advisors is often a significant focus for both the company and the dissident.

Canadian securities regulators are considering whether proxy advisors should be regulated. However, no specific proposals in that regard have been put forward as yet. ■

Reprinted with permission from *The 2013 Lexpert®/American Lawyer Guide to the Leading 500 Lawyers in Canada* © Thomson Reuters Canada Limited.

LEXPERT THOMSON REUTERS

Jon Feldman, *Goodmans LLP*
Tel: (416) 597-4237 • Fax: (416) 979-1234 • E-mail: jonfeldman@goodmans.ca

Partner. Practices corporate/securities law with a focus on M&A. Extensive experience acting for buyers and sellers in a range of industries for private and public companies. Has been involved in a number of contested shareholder matters, including proxy contests representing both dissident shareholders and boards of directors and is also often asked to participate in litigation matters where strategic advice is sought and knowledge of corporate/securities law is required. Formerly worked as a M&A lawyer in New York. Frequent author and lecturer on developments in the Canadian M&A market, the evolving role of shareholder rights plans and the rise of shareholder activism in Canada. Served as an Adjunct Professor at U of T Law School where he taught the course "The Art of the Deal". Recognized as one of *Lexpert*®'s "Rising Stars: Leading Lawyers Under 40" in 2011 and in *2012 Lexpert® Guide to the Leading US/Canada Cross-Border Corporate Lawyers in Canada* as a "Corporate Lawyer to Watch". Called to the Bars of New York (2000) and Ontario (2005).

Michael Partridge, *Goodmans LLP*
Tel: (416) 597-5498 • Fax: (416) 979-1234 • E-mail: mpartridge@goodmans.ca

Partner. Practices corporate/securities law with a focus on M&A, private equity transactions and corporate finance. Has extensive experience representing mining companies in high profile international M&A and corporate finance transactions. Advised Kilmer Sports Inc. and Lawrence Tanenbaum in connection with the Ontario Teachers' Pension Plan's sale of its ownership interest in Maple Leaf Sports and Entertainment Ltd. to BCE Inc. and Rogers Communications Inc. for C$1.32 billion; Western Coal Corp. in connection with its C$3.3 billion acquisition by Walter Energy, Inc.; US hedge fund, Mason Capital Management in connection with its investment in TELUS Corporation and ongoing opposition to TELUS' proposed elimination of its dual class share; and Hub International Limited in connection with numerous acquisitions in Canada. Formerly practiced at a Silicon Valley–based law firm where his practice focused on the representation of emerging growth companies, publicly traded technology companies and venture capital funds in M&A transactions, venture capital financings and general corporate/securities law matters. Corporate and securities law editor of the *Toronto Law Journal* and a former contributing editor of *Corporate Financing*.

THOMSON REUTERS LEXPERT

Reprinted with permission from *The 2013 Lexpert®/American Lawyer Guide to the Leading 500 Lawyers in Canada* © Thomson Reuters Canada Limited.