GOVERNANCE INSIGHTS 2023

As the Pandemic Abates, Activists Advance: Shareholder Activism Rebounds in Canada

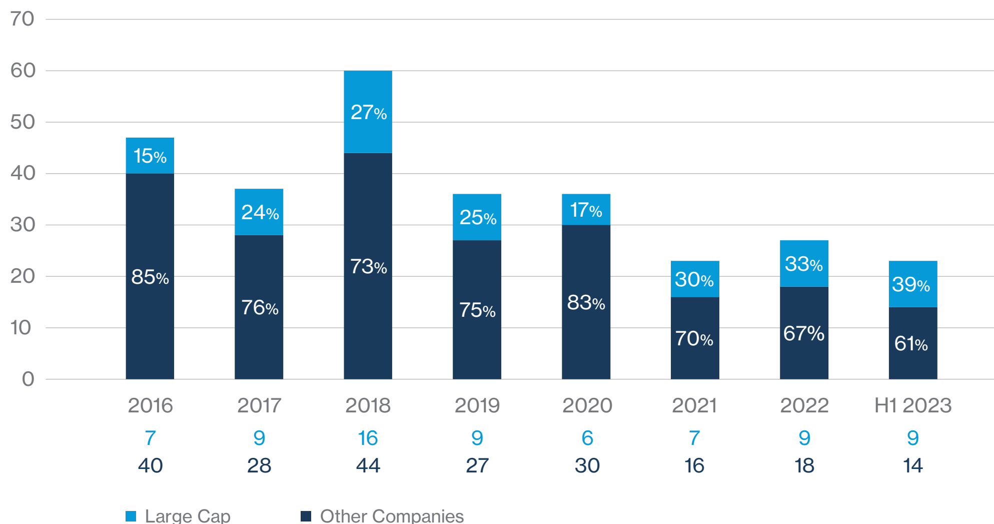
Shareholder activism in Canada experienced a resurgence in 2022 and into the first half of 2023 after an initial slump in the months following the onset of the COVID-19 pandemic in North America. Although the number of activist campaigns has not yet returned to pre-pandemic levels, the data reveal that large-cap Canadian listed companies—those with market capitalizations exceeding C$1 billion—have been disproportionately targeted, often by U.S. hedge fund activists seeking opportunities north of the border. Another emerging pattern is the "activist swarm," in which multiple, yet uncoordinated, activists converge on a single target with competing demands. Some swarms have arisen in opposition to M&A transactions, as M&A activism has also become more prevalent. In this instalment of *Governance Insights*, we examine these trends and include a short primer on key issues in the Canadian regulatory landscape for shareholder activism, offering insights for both issuers and activists. We conclude our review with an examination of key issues in contested M&A transactions.

The Past Year

At the halfway mark of 2023, the 23 board-related campaigns commenced to that time equalled the full-year total for 2021 and came close to the full-year total for 2022, indicating that the current year may eclipse 2022 in what portends a return to pre-pandemic levels of activity. After surprising stock market resilience in 2021 in the midst of the COVID-19 pandemic and an associated decline in activist campaigns, issuers suffered a reversal in fortunes in 2022. Over the course of the year, the S&P/TSX Composite Index dropped 8.71% and fundraising by Canadian public issuers declined substantially, with new stock issues plunging 73% to C$14.4 billion—from C$52.7 billion the previous year—and a staggering 64% below the most recent 10-year average of C$40.4 billion. With issuers' share prices in decline and balance sheets weakening, it came as little surprise that activist campaigns rebounded from their 2021 low point. That rebound looks set to continue.

> Frothy markets spurred partly by unprecedented government pandemic-era spending may have allowed issuers to avoid confronting fundamental weaknesses in their businesses. With a return to normalcy, it might be said that "the tide is going out," leaving those issuers exposed to restive activists with capital to deploy.

Figure 1: Number of Canadian Issuers Subject to Activist Demands (2016–H1 2023)



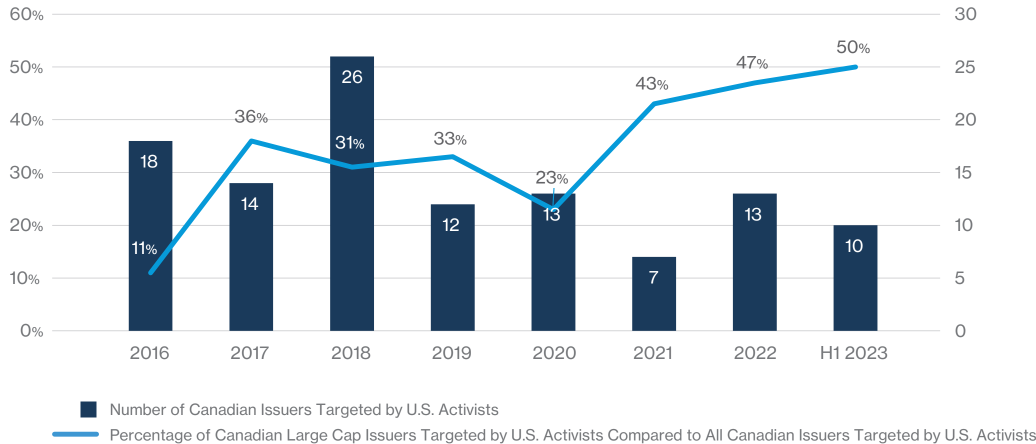
Source: Diligent Market Intelligence

BIG-GAME HUNTING: ACTIVISTS FOCUS ON LARGER COMPANIES

According to Bloomberg data, only 9.5% of issuers on the Toronto Stock Exchange (TSX) and TSX Venture Exchange have a market capitalization exceeding C$1 billion, yet such companies were targeted in 39% of all Canadian activist campaigns in the first half of 2023. As highlighted in Figure 1, the number of these larger targets has been increasing since a low in 2020.

This uptick in activism affecting larger companies has increasingly been driven by U.S.-based activists. Since the beginning of 2022, U.S.-based shareholders seeking change at Canadian-listed companies were responsible for almost half of all Canadian activist demands directed at these larger issuers. This may be explained in part by the fact that U.S.-based professional activists are more likely to target larger issuers, given the amount of capital they wish to deploy and the liquidity needed to build a meaningful stake without moving the market.

Figure 2: **Historical Proportion of Demands by U.S. Activists for Canadian Large-Cap Issuers**

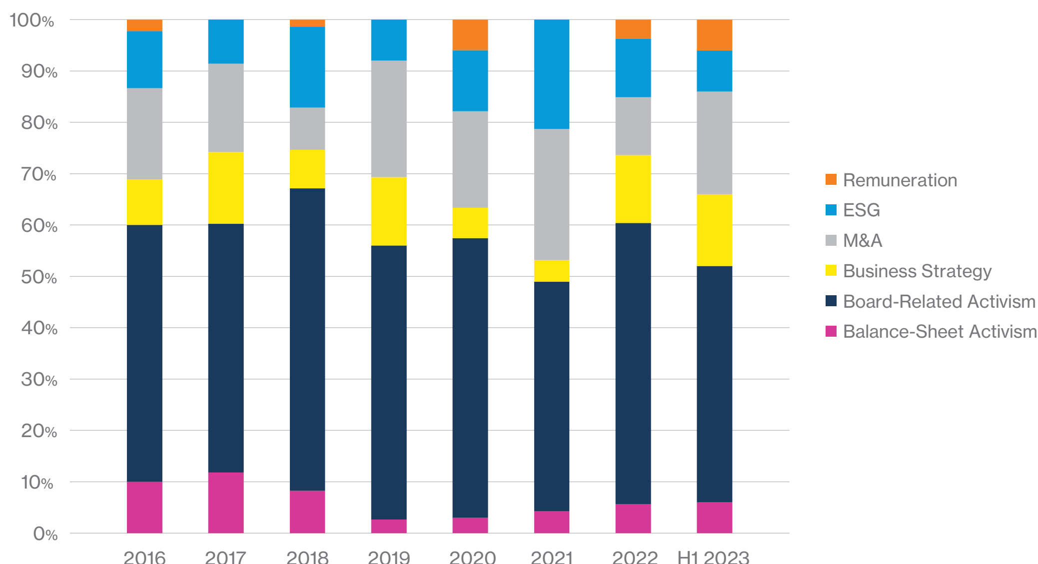


ACTIVISTS RECALIBRATE THEIR CAMPAIGNS IN THE POST-PANDEMIC ERA

In addition to the trending increased activity, the data for the last few years on the mix of activist demands made against Canadian issuers suggest that activists may also be recalibrating their messages in the post-pandemic era. For example, activists did not couple their campaigns with concerns regarding executive compensation in 2021, but such demands have since been on the rise. In addition, demands relating to environmental, social and governance (ESG) factors may also be falling out of favour, with the proportion of such demands declining from 21% in 2020 to just 8% of all demands in the first half of 2023. Such a decline may reflect the shifting and sometimes polarizing attitudes to ESG investing more generally (for additional information regarding the ever-changing ESG landscape, see "Charting a (Safe) Path Through the ESG Wilderness").

One type of demand that is often made independently of board-related demands is M&A activism, which, as of H1 2023, is back on the upswing, representing 20% of all demands made. These demands generally involve an activist pushing a target to implement a transaction or actively challenging an announced transaction. A recent prominent example of such a campaign was the Ritchie Bros. Auctioneers Incorporated's acquisition of IAA, Inc., which is further discussed below.

Figure 3: Public Demands to Canadian Issuers Proportionally by Type of Demand (2016–H1 2023)



Source: Diligent Market Intelligence

The Rise of Activist Swarms

In the last year, a relatively new phenomenon some call "activist swarms" has emerged. Defined by Bloomberg as multiple shareholders of a single issuer making contemporaneous, but uncoordinated, public demands from the company's leadership, these activist swarms made headlines in 2023.

In Canada, First Capital Real Estate Investment Trust (First Capital) and Ritchie Bros were targeted by multiple shareholders. The trend holds globally as well, including in the United States, where prominent firms like Walt Disney Co., Salesforce Inc. and Bayer AG have faced pressure from multiple activists, with demands spanning management overhauls to proposed spinoffs and divestitures.

Responding to an activist swarm can be challenging given the disparate demands and multiple constituencies involved, all with their own objectives. One response strategy is to "divide and conquer" by seeking to placate certain shareholders in the group while isolating those whose demands might be more challenging to satisfy. This strategy was witnessed in the United States in Salesforce's settlement with ValueAct Capital, which involved four other activists, and in Canada in First Capital's settlement with Ewing Morris and Co. and Vision Capital Corp. This

latter settlement led to a subsequent settlement between First Capital and Sandpiper Group, whereby Sandpiper withdrew its meeting requisition and board nominees and agreed to a standstill in exchange for a reimbursement of its expenses. Ritchie Bros' proposal in 2022 to acquire IAA attracted attention from at least eight activists, including Starboard Value LP, Luxor Capital Group, LP, Ancora Holdings Group, LLC, and the Janus Henderson Group plc, all pulling in opposing directions. Ultimately, Starboard made a strategic investment in Ritchie Bros, which allowed Ritchie Bros to revise its offer to acquire IAA and garner sufficient support to approve the transaction, notwithstanding continued opposition from Luxor.

One strategy to respond to a swarm would be to "divide and conquer" by placating certain shareholders in the group and therefore isolating those whose demands might be more challenging to satisfy.

Key Issues in Canadian Shareholder Activism: A Refresher

In light of U.S. activists' increased interest in Canadian companies, we set out below a refresher on shareholder activism in Canada, which compares and contrasts relevant Canadian rules with their U.S. counterparts.

UNIVERSAL PROXIES

Canadian proxy rules have always permitted an issuer or a dissident shareholder to use a "universal" proxy card that lists the names of each management director nominee and each dissident director nominee. With a universal proxy, a shareholder may choose any combination of directors it determines would be best. In contrast, the typical form of proxy, whether used by a dissident or the issuer, lists only that party's nominees, forcing a shareholder voting by proxy to choose one side's nominees over the other. In these circumstances, the shareholder would have to attend the meeting in person in order to vote for a mixed slate of nominees proposed by an issuer and a shareholder in a contested director election.

This is distinct from the recently amended U.S. proxy rules which now *require* issuers and shareholders to use a universal proxy card (UPC) listing the names of all director candidates in a contested election. Consequently, shareholders can now mix-and-match their preferred nominees from the issuer's and the activist's slates. As a result of these amendments, U.S. proxy rules are now more shareholder-friendly than their Canadian counterparts since U.S. issuers are *required* to use a universal proxy in a contested election, whereas Canadian issuers merely have the *option* to do so.

U.S. issuers, as well as Canadian issuers that are recognized as U.S. domestic issuers by the U.S. Securities and Exchange Commission (SEC), have amended their advance notice bylaws owing to the SEC's recent introduction of the UPC. The intent behind these bylaw amendments is largely to ensure that an issuer's bylaws operate effectively in a contested director election under the UPC rules. However, some issuers have used the opportunity to make additional bylaw changes unrelated to the UPC rules that make the nomination process more challenging for shareholders.

ADVANCE NOTICE BYLAWS

Canadian practice regarding advance notice bylaws generally yields more shareholder-friendly bylaws compared with bylaws of U.S. issuers, which are significantly more issuer-friendly. U.S.-style bylaws create many more opportunities for potential non-compliance — and therefore refusal to recognize nominees — given the voluminous disclosure obligations typically imposed. Consistent with TSX regulations, proxy advisory firms such as Institutional Shareholder Services Inc. (ISS) in its Canadian guidelines oppose any provisions in an advance notice bylaw that impose unnecessary disclosure obligations on shareholders regarding the nomination of directors. For example, requiring the nominating shareholder to complete a nominee questionnaire is generally considered an undue burden if the requested information exceeds what is required in a proxy circular or demands information beyond what is required to be disclosed under law or regulation. Conversely, ISS's U.S. guidelines generally support U.S.-listed companies seeking information from a nominating shareholder (e.g., by way of a nominee questionnaire) as long as the information being requested is reasonable and aimed at providing shareholders with the necessary information to review the proposal. ISS also considers a myriad of other features in advance notice bylaws as problematic under its Canadian policies as compared with its U.S. policies, such as requiring a nominating shareholder to commit to being present at the meeting at which their nominee is standing for election.

U.S. issuers, as well as Canadian issuers that are recognized as U.S. domestic issuers by the SEC, have amended their advance notice bylaws owing to the SEC's recent introduction of the UPC. While the stated purpose of these bylaw amendments is to adapt bylaws for the UPC rules, some issuers have taken the opportunity to add additional issuer-friendly requirements that are not dictated by the UPC rules. For example, some issuers have amended their advance notice bylaws to demand more extensive disclosure about the nominating shareholder and its proposed director candidates, a move seemingly designed to deter activist investment funds from initiating proxy contests. Such changes include requirements for investment funds nominating directors to reveal their fund investors, and for nominating shareholders to share details such as third-party financing sources, planned director nominations or proposals at other issuers, prior communications with other shareholders of the issuer, and possible conflicts concerning the director nominees.

In the most well-known instance of a company adopting such bylaws, Politan Capital Management LP, an activist fund, took legal action in the Delaware Chancery Court against the board of Masimo Corporation for its bylaw changes. The disputed amendments demanded that investment funds nominating directors disclose all fund investors holding a 5% or larger interest. Facing wide-spread criticism from the governance community and others, including even members of the activism defence community, Masimo retracted these and other changes before the Court's decision.

In Canada, Primo Water Corporation, an Ontario-incorporated TSX-NYSE-listed issuer, amended its advance notice bylaws to introduce U.S.-style barriers to the nomination process following contact from Legion Partners Asset Management. After initially rejecting all of Legion's nominees in a subsequent proxy contest on the basis of alleged deficiencies in the nomination notice, Primo ultimately settled with Legion following Legion's commencement of an oppression application in the Ontario courts concerning the legality of the amended advance notice provisions, resulting in an agreement to appoint two Legion nominees to the Primo board and Primo agreeing to adopt certain governance enhancements, including revisions to the advance notice bylaw to bring them in line with Canadian standards.

MAJORITY VOTING

All TSX companies are required to provide for majority voting for directors at uncontested meetings. In the case of TSX companies that are not incorporated federally, issuers must adopt a policy that provides that their board must accept the resignation of a director who fails to obtain the requisite percentage of votes, barring undefined "exceptional circumstances." Following recent amendments to the *Canada Business Corporations Act*, directors of Canadian federally incorporated companies, regardless of the company's listing, must now be elected by a majority vote at all uncontested shareholder meetings in order to be duly elected (for an overview of majority voting rules in Canada, see "True Majority Voting for CBCA Public Companies: Is Your Board Ready?").

NO STAGGERED BOARDS

While staggered boards remain a feature of many public companies in the United States, Canadian corporate statutes generally provide that the shareholders may, by simple majority resolution, remove one or more directors from office and elect their replacements. This right, coupled with the right of shareholders holding 5% of the shares to requisition meetings to remove directors, prevents Canadian corporations from implementing "classified" or "staggered" boards in which directors are elected for multiple-year terms with only a subset of the board subject to turnover at any given annual meeting. Moreover, the TSX rules prevent classified boards for TSX-listed issuers by requiring that shareholders be permitted to vote on the election of all directors at each annual meeting of shareholders.

ABILITY TO REQUISITION A MEETING

One of the most powerful rights that shareholders of Canadian corporations enjoy is the statutory right of holders of not less than 5% of the issued voting shares to requisition a shareholders' meeting. On receiving a valid requisition proposing proper shareholder business—most commonly to remove and elect directors—the directors must, within 21 days, call a meeting of shareholders to transact the business stated in the requisition. Although the directors generally have broad discretion as to when the meeting is actually held, a recent decision of the Ontario Superior Court of Justice strengthened the hand of dissidents by emphasizing a board's obligation to hold the meeting "without unreasonable or unjustifiable delay."

PROXY SOLICITATION EXEMPTIONS

Canadian securities laws provide shareholders with two important exemptions from the requirement to mail a proxy circular to shareholders in connection with a solicitation. One such exemption, the "private

proxy solicitation exemption," allows shareholders (but not the company) to privately solicit up to 15 shareholders. This method of solicitation is relatively inexpensive and may be effective when the ownership of voting shares is concentrated. The other commonly used exemption is known as the "public broadcast exemption." Similar to the private proxy solicitation exemption, this is available only to the shareholder, not the company. The public broadcast exemption entitles shareholders to communicate by press release, public broadcast, website or public speech, subject to filing prescribed materials and related disclosure on SEDAR, together with the communication intended to be published. For activists seeking to rely on this exemption in connection with the election of directors, a document containing prescribed information concerning the proposed nominees must also be filed on SEDAR, but need not be mailed to shareholders. This approach can be effective in avoiding significant cost in a "withhold" or "vote no" campaign by a dissident shareholder. It can also be used to give the dissident shareholder a head start in the fight by soliciting other shareholders before the target company's circular has been released.

TEN PERCENT EARLY WARNING THRESHOLD

Shareholders acquiring a significant position in a Canadian listed company are generally required to issue a public early warning report once they acquire beneficial ownership of 10% or more of any class of equity or voting securities of the company. Upon reaching 10%, the shareholder is required to promptly announce its acquisition by press release, file an early warning report within two trading days of the acquisition and stop acquiring any further securities of the relevant class for one full trading day after the filing of the early warning report. Thereafter, the shareholder must report increases and decreases of 2% or more, as well as when shareholdings fall below the 10% ownership threshold. The foregoing early warning requirements do not apply to shareholders filing under the alternative monthly reporting system (AMRS), which is available only to passive shareholders (shareholders that are not soliciting proxies from other shareholders) that qualify as "eligible institutional investors." Under the AMRS, rather than issue an immediate report, the shareholder must file a report within 10 days of the end of the month in which the 10% threshold is crossed.

Compared with the U.S. 13D threshold of 5%, Canada's 10% trigger may be viewed as more lenient; however, the U.S. rules provide a considerably longer grace period for disclosing one's position—the initial report must be filed within 10 days (soon to be shortened to 5 business days) of tripping the threshold, and the investor can continue accumulating in that time period. In contrast, Canadian rules require the investor and its joint actors to cease purchases and immediately notify the market once the threshold is crossed and cannot purchase additional securities until one business day after the early warning report is filed, subject to a limited exception for shareholders holding over 20%. As a result, in practice, the real reporting threshold in the United States is not 5% but rather 5% *plus* whatever else the activist can acquire in the period before the report is due. This has led to numerous cases in which the initial report is in excess of 5% and even in excess of the Canadian threshold of 10%.

Our Take: Lessons From Recent Contested Situations in Canada

Recent contested Canadian M&A situations offer valuable lessons for corporate boards, special committees and potential bidders alike. These cases highlight the need for transparency, due diligence and strategic communication, emphasizing the importance of meticulous planning and stakeholder engagement. The increased involvement of activists in contested M&A transactions underscores the need for careful preparation, including anticipating public arguments against the deal and effectively communicating the strategic rationale of the transaction to shareholders. A thorough understanding of the legal landscape, particularly the increasing judicial scrutiny of fairness opinions, is also critical. In an era marked by rapid changes in market conditions and heightened activist and judicial scrutiny, these lessons serve as a road map for navigating the complexities of contested M&A transactions.

FUNDAMENTAL VALUE IS KEY

No theme is more pervasive within the M&A space than value. While bidders and targets focus on trading prices and premium in addition to other relevant deal terms, activists often focus on fundamental value; if a transaction does not align with an activist's value expectations, the activist may vocalize its opposition to the transaction. In recent years, a number of activists have made their value expectations public, either providing management with a mandate to renegotiate terms or pushing management to terminate the transaction and focus on its stand-alone plan.

The work completed by a bidder and its financial advisers prior to the announcement of a transaction is crucial to their ability to later defend their strategic choices. On the other side of the transaction, boards should focus on the independence and rigour of their process. For instance, in 2023, Nellore Capital was highly critical of both the fact that Magnet Forensic Inc. (MFI) announced its 15% premium transaction with Thoma Bravo prior to the release of favourable financial results and the fact that the transaction allowed certain MFI insiders to roll their shares into Thoma Bravo's acquisition vehicle. Nellore implored shareholders to question the value they were

receiving for their shares, given the apparent conflict of interest. While Nellore ultimately lost its challenge against the MFI-Thoma Bravo transaction, the case stands as a cautionary tale for both acquirers and targets. It highlights the critical importance of timing when announcing transactions, especially close to the release of material financial information. The controversy also underscores the need for boards to diligently assess potential conflicts of interest, because conflict transactions often attract activist challenges that—even if unsuccessful—can tarnish reputations, create deal risk and result in increased transaction costs.

Boards should also consider the judicial landscape when navigating M&A transactions, particularly with respect to fairness opinions, since failure to do so could jeopardize a deal. As most Canadian M&A transactions proceed by way of court-approved arrangement whereby the court must rule on the procedural and substantive fairness of the arrangement, the fairness opinion of the board's financial adviser is a key component of the board's process to approve the arrangement. Recent pronouncements on these arrangements by Ontario courts indicate that fairness opinions will be subjected to greater scrutiny, including the compensation structure of the adviser (i.e., whether compensation is based on a fixed fee or is contingent on the successful completion of the transaction) and the degree of analysis disclosed in the fairness opinion. Similar considerations apply in cases where the buyer must obtain approval of its own shareholders for a transaction. As seen in Luxor's campaign against Ritchie Bros discussed below, fairness opinions will not only be examined by the courts but can also be challenged by activists that perceive weaknesses in the independence of the financial adviser or in the methodology and approach taken.

In Context. In a 2023 campaign centred on value and strategic benefits, Ritchie Bros and Luxor sparred over the benefits of a transaction whereby Ritchie Bros would merge with IAA. As part of its campaign, Luxor accused Ritchie Bros of manipulating the conclusion of the fairness opinion relating to the transaction by introducing new, less optimistic forecasts after the deal price was agreed to, two weeks prior to the announcement of the transaction, and requiring its advisers to rely on what Luxor claimed to be "low-ball" estimates of its valuation. Luxor prepared and filed detailed analysis, essentially alleging management had misrepresented its future potential to the market and underplaying the value of Ritchie Bros. In response to Luxor's criticisms, Ritchie Bros issued multiple shareholder letters, pushing back on Luxor's assertions and alleging mistakes in Luxor's analysis. Ultimately, Ritchie Bros was successful in swaying the narrative and received 54% of shareholder support, a narrow margin of victory but sufficient to approve the merger.

SUPPORT FROM PROXY ADVISORY FIRMS

Given the increasing proportion of shares held by institutions, winning support for a transaction from proxy advisory firms, such as ISS and Glass, Lewis & Co. (Glass Lewis), is often viewed as critical. Failure to obtain approval from proxy advisory firms is not necessarily fatal—as evidenced by the ultimate success of the IAA and MFI transactions in the face of negative proxy adviser recommendations; however, boards would be well advised to reflect on the factors that such proxy advisory firms will analyze in recommending a vote and to consider bolstering their disclosure by highlighting deal strengths and proactively addressing potential weaknesses. Proxy advisory firms will consider, among other things,

- the valuation of the transaction and whether the value is fair to shareholders;
- how the market has responded to the announcement of the transaction, and whether heightened scrutiny is required due to a negative reaction;
- whether there is a strategic rationale for the transaction and whether management has a favourable track record of successful integration of historical acquisitions;
- whether the terms of the transaction were negotiated at arms length;
- whether management secured a number of negotiation “wins”;
- the comprehensiveness of the sales process;
- the presence of conflicts of interest;
- the governance profile of the combined company.

In assessing overall vulnerability to ISS and Glass Lewis recommendations, companies should have a clear understanding of their shareholder base and whether shareholders subscribe in significant numbers to reports from such proxy advisers. Additionally, companies should engage a proxy solicitation adviser to help identify a path to securing the required votes by contacting shareholders and identifying potential allies, even in the face of a negative proxy advisory firm recommendation.

Note on the data: Activism data in this chapter was sourced from Diligent Market Intelligence and excludes shareholder proposals.

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