A new age of shareholder activism

Big investors are antsy. Canadian boards need to up their game and have a plan in case an activist comes knocking, **Jeff Buckstein** writes

INCREASED SHAREHOLDER ACTIVISM is having a big impact on Canadian boardrooms across the country, taking its toll on directors. That's especially the case when a proxy battle is sparked, putting control of the boardroom at stake, as recent high-profile battles at companies including Aimia Inc., Suncor Energy Inc. and First Capital REIT can attest.

"Proxy fights are not only expensive, resource-consuming, [and] time-consuming, they're also emotionally, physically, [and] mentally exhausting for people who are involved in them. Boards need to understand that when they're getting into these situations, they really need to steel themselves for a long fight [for control of the company]," says Ian Robertson, CEO of Kingsdale Advisors, a Toronto-headquartered firm that helps public companies with shareholder, governance and transaction-related matters.

The threat can also become personal. "It's not uncommon in these situations where an activist would go out and hire a private investigator to do a deep dive individually on the directors, and at least use portions of the information in a fight," he warns.

There were, according to Kingsdale data, 35 proxy contests across Canada between July 1, 2022 and May 25, 2023.

"Our firm has been in business for 20 years and the last 14 months have been the busiest that we have had to date," Robertson says. "There's always a lot of speculation about 'Is activism going away or is it

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here to stay?' Everything I have seen is saying, 'Not only is it here to stay; it's going to accelerate.'"

Certain sectors such as real estate investment trusts (REITs), technology, industrials and mining have been particularly ripe for proxy action. "Part of what's driving the activity in those industries are low valuations, opportunities for M&A, and just a sense there are a lot of opportunities here for companies that haven't been explored," says Robertson.

There is also much more activity going on behind the scenes, with only about one-third of activist approaches becoming public knowledge, he notes.

Most shareholder activists today stop short of demanding wholesale change.

Today, rather than hostile bids and takeovers, which have a low rate of success, there tend to be more engaged discussions or consensual takeovers, says Fred Mifflin, vice-chair of Blair Franklin Capital Partners in Toronto. "I think the activist route has replaced what was happening historically in hostile takeovers. With activism, you could effect change without having to buy 100 per cent of the company. I think that's why it has proven to be so effective," he explains.

Scott Leckie, principal and chair of 7th Merchant Corp., a private merchant bank in Toronto, says he has seen many situations initiated by activists that end with a negotiated settlement, through which there are board changes. The new board members might or might not be the members the activists were originally seeking to install, but the net result is a change to the board composition.

Subsequent changes to management could also follow, explains Leckie, who is also a director of financial software company Abaxx Technologies Inc., and chair of that company's audit committee.

Wide-ranging agenda

The agenda of shareholder activists varies widely, although many are focused on traditional metrics of financial performance.

Most shareholder activists are investor groups that see an opportunity in the gap between the actual and prospective stock value of the company they are interested in. "They think they can, by being active, close that gap and take advantage of the arbitrage," says Michael Detlefsen, managing director of Pomegranate Capital Advisors Inc. in Toronto.

Directors need to understand that activists can cause reputational damage to a company, says Detlefsen, who serves on the boards of Rubicon Organics Inc., Phoenix Canada Oil Co. Ltd., and Sunrise Foods International Inc., a private company. They might, for instance, accuse it of greenwashing its environmental record, or they could launch a direct frontal assault on its governance practices or financial performance, he says.

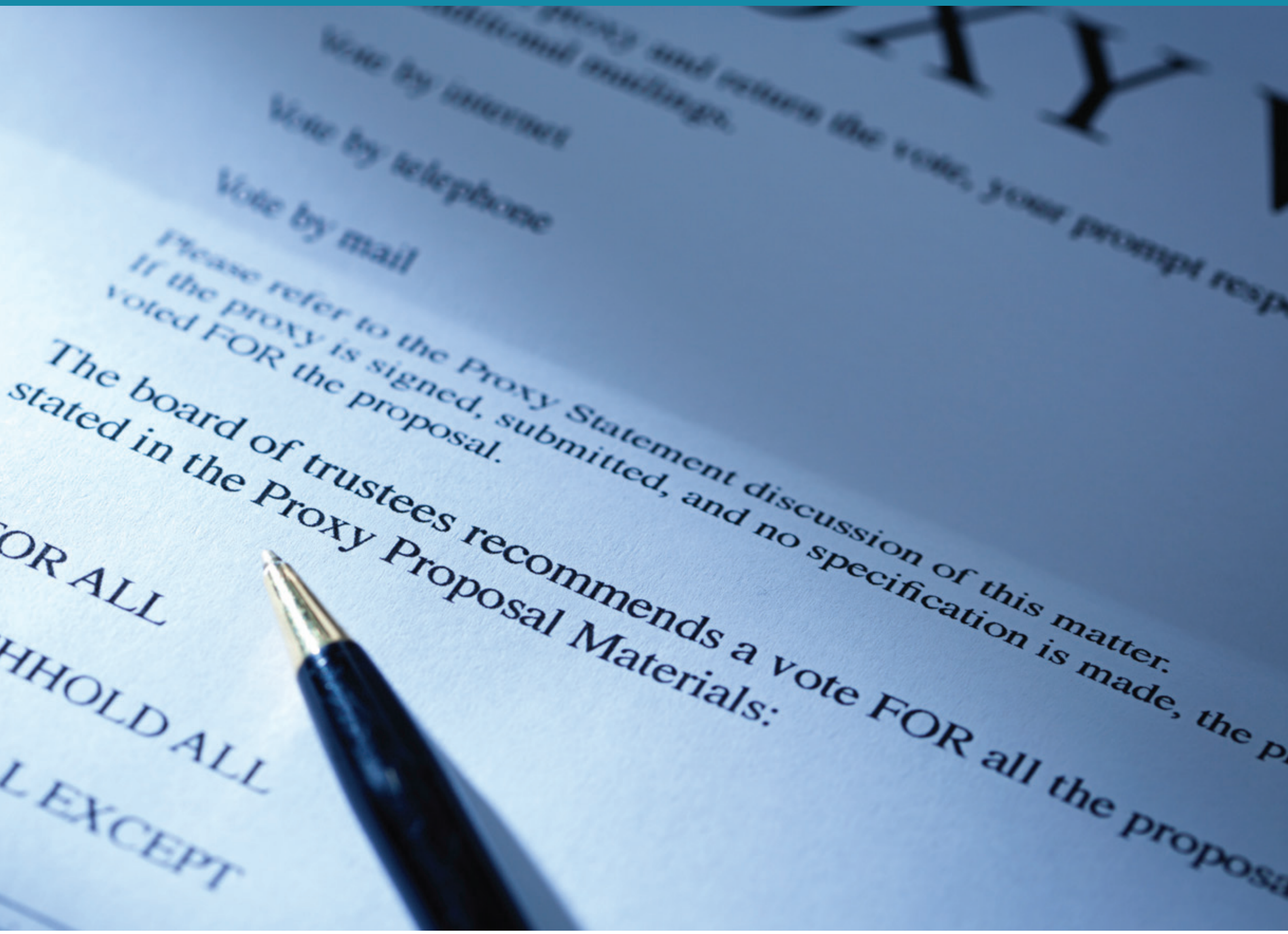
If, for example, a corporate stock has precipitously declined, activists can raise damaging public questions such as "Where was the board? Where was management? Why don't they seem to be doing anything about it?" The board could get tagged with a perception of ineffectiveness, which is a reputational risk, he says.

Likewise, if a company's compensation committee is viewed as having paid itself and the CEO and management too much in relation to performance or without benchmarking pay against comparable companies, that can also be very damaging to the entire board, Detlefsen adds.

Economic conditions, including volatile stock markets, poor performance by certain companies and rising interest rates in a slowing economy, have shone a brighter light on corporate weaknesses, and are the main reasons behind the increase in shareholder activism today, Mifflin says.

Environmental, social and governance (ESG) issues have also become an area of greater focus for boards and activists.

Canadian securities regulators are focused on ESG and climate-related disclosure and, as more information is provided



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by companies and clearer rules are developed about what needs to be disclosed, "there will be more ammunition given to activists … to be able to deploy their strategies," says Karrin Powys-Lybbe, a partner with Torys LLP in Toronto.

A board's duties

The old adage about prevention being better than a cure also applies to director diligence in the face of shareholder activism. Directors need to be aware that activists are generally looking for certain red flags on their company's financial and operational performance. Attention to such details could dissuade activists from targeting them.

For example, continual turnover on the board or among management is an operational risk that might make a company more susceptible to shareholder activism, Leckie says.

‘I think there’s a tendency to sort of shut the door and circle the wagons, and that’s detrimental because often the activists do have good points.’

–Michael Detlefsen, managing director, Pomegranate Capital Advisors

Capital allocation is also critical. If a company is not getting a satisfactory return on invested capital, it leaves an opening for activists to come in and attack, Detlefsen adds.

“A lot of companies I’ve seen who’ve come under attack, they’ve taken on a massive project [such as] a pipeline [or a] massive new factory where they are spending capital equal to more than 25 or 30 per cent of the total value of shares in the company,” says Detlefsen.

“And so, the activists can come in and say ‘You’re betting the farm. Have you really thought about how to manage this? How to mitigate the risks? It doesn’t look like you have,’ and so they’re highly critical that way.”

Boards, along with management, need to ensure they are managing their debt load and working capital, and are aware of any discounts to underlying assets. In the REIT space, for example, activists might take aim at the significant discount on commercial properties coming out of the pandemic, Robertson says.

Boards and management need to ensure they perform in such a way that their stock price is fully valued, and the company is at the top of its peer group. “There is nothing that prevents activism or hostile takeovers more than a fully valued stock price,” says Mifflin.

Even when a company is performing well, and that is reflected in its stock price, boards cannot rest on their laurels and assume that nobody will take a run at them. “Fortunes can change. Markets can change,” Mifflin warns.

Boards should, therefore, figure out how they will engage “in the event somebody comes calling,” he adds.

It is also important for the board to look inward, with respect to issues such as tenure and share ownership and up-to-date expertise, and be willing to refresh its membership as needed, Robertson says.

“You always need to be thinking about ‘While I may have the board I need for today, what about tomorrow? How do I get ahead of what a shareholder is likely to point out to me about my board? What is the transition process?’”

A well-functioning board should include directors with a well-rounded set of experiences, including from other industries and professional backgrounds. “Some of the best questions will be asked by somebody who’s not actually 100 per cent up to speed with the specifics of the industry or the company, but that has a broader knowledge and curiosity about how things work,” Leckie says.

Such questions could bring up interesting new perspectives that might not otherwise have come under consideration because of the tendency for people with similar backgrounds in similar fields to think alike, he adds.

Experts also stress that engaging with activists can potentially yield positive results.

"I think there's a tendency to sort of shut the door and circle the wagons, and that's detrimental because often the activists do have good points. If management or the board is willing to listen and think about it hard, and make some changes, it can improve the performance of the company," Detlefsen says.

"It doesn't necessarily lead to a proxy battle or an all-out litigious environment. There's no harm in listening," he adds.

"I think the mistake that some companies make is they try to slough off the activists. These are smart people and they may have very good ideas, and good recommendations of board candidates," says Leckie, who notes that their suggestions may be beneficial because boards are always looking for renewal and high-quality individuals.

That type of symbiotic relationship might prove to be the wave of the future, serving the vested interests of both board members and activists, with the latter now appearing to be entrenched for the long haul.

Critical limits

Once an investor purchases at least 10 per cent of a Canadian company, that information must be publicly disclosed. That is a much richer holding than the 5-per-cent threshold set in U.S. capital markets, says Leckie.

However, even though an activist in Canada doesn't need to disclose their position until they reach 10 per cent, they only require a 5-per-cent stake to requisition a meeting of shareholders over a matter of interest to them, at which time their identity would become visible, Robertson says.

"That means that if I am an activist [and] I want to get some wins under my belt, Canada is an excellent jurisdiction to do that," he says.

However, boards also have certain defensive tools at their disposal, particularly where shareholder activism leads to prospects for a hostile takeover.

In 2016, Canadian Securities Administrators tripled the minimum amount of time that a proposed takeover bid must remain on the table, to 105 days from 35 days, with certain exceptions.

"The playing field in Canada has become much more difficult for hostile bids, and we've seen fewer hostile bids as a result of that change, among others," Powys-Lybbe says.

"It used to be that shareholder-rights plans, or what people called 'poison pills,' were implemented by boards in order to give them more time in the face of a hostile offer. In Canada, the rules have been changed to essentially mandate that everyone's got time. And so, the 105 days means there's time for a board to find an alternative, or to make their case as to why the company shouldn't be sold," she says.

Canadian boards also enjoy a relative degree of flexibility compared with their U.S. counterparts with respect to expressing their point of view.

In the United States, the Securities and Exchange Commission has tighter rules and restrictions regarding communicating with other shareholders. For example, prior to sending a proxy circular, it needs to be reviewed by the SEC, but in Canada, a circular can be sent without having to go through any third-party regulatory review, Robertson says. **DJ**

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A NEW TOOL FOR ACTIVISTS

Amendments to the Canada Business Corporations Act (CBCA), which came into force in 2022, changed how shareholders of publicly listed corporations can vote for directors in uncontested elections.

Rather than simply withholding a vote, and allowing directors to be installed with a plurality, shareholders can now register votes against, meaning outright majority support is now required for election or re-election to a board. If more votes are cast against than cast in favour, the election or re-election bid would fail, says Ian Robertson, CEO of Kingsdale Advisors in Toronto.

"We've already had three campaigns this year where a shareholder who would lack the means to run a full formal campaign goes out and solicits their own proxies," says Robertson, in the hope that targeted candidates would fall below the 50-per-cent threshold and resign.

"It's a new mechanism, in that it's been formalized. A lot of companies have historically had majority voting policies and withhold votes. But the introduction of formal 'against votes,' I would say, [is] a tool activists can use to express their displeasure with a company, short of running a full, expensive campaign," he says.

– JB