

ONTARIO SUPERIOR COURT CLARIFIES “UNREASONABLE OR UNJUSTIFIABLE” DELAY FOR REQUISITIONED MEETINGS

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Introduction

On February 1, 2023, the Ontario Superior Court of Justice (the “**Court**”) issued a decision, *Sandpiper Real Estate Fund 4 Limited Partnership v. First Capital Real Estate Investment Trust*, 2023 ONSC 794 (the “**Decision**”), ordering First Capital Real Estate Investment Trust (“**First Capital**”) to call and hold a special meeting of its unitholders (the “**Unitholders**”) two months earlier than First Capital’s scheduled annual and special meeting of May 16, 2023. The Decision is a result of an application by Sandpiper Real Estate Fund 4 Limited Partnership (“**Sandpiper**”) and associated entities who were Unitholders of First Capital, to compel First Capital to hold a Unitholder meeting on March 1, 2023 or as soon as practical thereafter.

Sandpiper had previously requisitioned a special meeting of Unitholders (the “**Requisition**”) in December 2022 to replace four independent members of the board of trustees of First Capital (the “**Board**”) with four of Sandpiper’s own nominees. The Board opted to hold a combined annual general and special meeting on May 16, 2023, more than five months after the Requisition. The Decision provides some guidance on the analysis that a court will engage in when determining whether the delay between a requisition and a meeting is unreasonable.

Background

On September 22, 2022, First Capital announced an enhanced capital allocation and portfolio optimization plan (the “**Optimization Plan**”). On September 28, 2022, First Capital announced its first disposition under the Optimization Plan for gross proceeds of \$149 million.

Between October 6 and October 13, 2022, representatives of Sandpiper engaged with First Capital with respect to Board representation for Sandpiper. These discussions included allowing the Optimization Plan to unfold through the summer of 2023 under the oversight and supervision of a newly constituted Board on which Sandpiper had appointed nominees. The discussions terminated on October 13, 2022 following concerns raised by First Capital regarding the independence of Sandpiper’s proposed nominees.

On December 12, 2022, Sandpiper delivered the Requisition for a meeting to be held no later than March 1, 2023. On December 14, 2022, the Board convened a joint meeting of the Board and First Capital's Corporate Governance Committee to consider the Requisition. This meeting was attended by the full Board, members of senior management, internal and external legal counsel and other professional advisors. The joint meeting lasted over two hours, however, the Requisition was not the only agenda item. Subsequently on December 30, 2022, First Capital announced that it had called a combined annual and special meeting of Unitholders to be held on May 16, 2023 to address both normal course matters and those raised in the Requisition.

On January 3, 2023, Sandpiper informed the Board that they would agree to a May 16, 2023 meeting date in exchange for an undertaking from First Capital that it would not proceed with any further dispositions under the Optimization Plan in the interim (the "**Undertaking**"). On January 5, 2023, First Capital advised Sandpiper that it was not prepared to provide the Undertaking.

Legal Framework

The Court outlined the legal framework informing its analysis. The Court noted that pursuant to the declaration of trust of First Capital, a requisitioned meeting must be called within 21 days after receiving a requisition. The determination of the timing of the meeting is "left to the business judgment of the directors to be determined by them acting honestly, in good faith and with a view to the best interests of the corporation". In determining whether the Board properly exercised its business judgment, the Court noted it may consider the Board's process, the grounds upon which the Board's decision was made and the factors it took into consideration. Courts must defer to the business judgment of the Board where its decision falls "within a range of reasonableness".

Issues

The Court outlined the two issues to be decided as follows:

1. Whether the procedure followed and factors considered by the Board in selecting the May 16, 2023 meeting date are such that the Court should defer to the Board's decision; and
2. If the Board's decision is determined not to be deserving of deference, whether the delay in waiting to hold the special meeting is unreasonable or unjustified, and whether First Capital should be compelled to hold the special meeting at an earlier date.

Analysis

The Degree of Deference to be Afforded to the Board's Business Judgment

The Court noted that the principle of deference in this context is dependent upon directors engaging in

scrupulous deliberations and demonstrating diligence in their arrival at decisions. The Court found that the procedure followed and the factors considered by the Board in reaching its decision about when to call the special meeting did not warrant a high level of deference from the court.

In particular, the Court found the following features of the Board's process warranted a low level of deference:

1. the Board held a single meeting on December 14, 2022 to discuss the Requisition (among other items) with discussion regarding the Requisition and the timing of the special meeting lasting less than two hours. Additionally, the trustees that Sandpiper was seeking to replace were present at, participated in and voted on the resolution passed at the Board meeting with respect to the date of the special meeting;
2. the Board identified factors that the court in another case considered to be sufficient to justify a five month delay in calling a meeting following a requisition without regard to the unique characteristics of First Capital; and
3. the Board was in favour of delaying the special meeting until after another quarter of financial and performance activity, to allow the Optimization Plan to continue to unfold. As further discussed below, the Court viewed this as prejudicing the requisitioning Unitholders and those other Unitholders who supported the Requisition, given its subject matter.

Was the Special Meeting Called Expeditiously and Within a Reasonable Time?

Having found that a low level of deference to the Board's decision was warranted, the Court found that as a starting point, a delay of five months to hold a special meeting requisitioned by Unitholders is an unreasonably long time to wait. However, the Court noted that the particular circumstances must be examined, including the justifications given by the Board for the date picked. These justifications included:

1. the costs and distraction of holding two meetings;
2. the desire to give the Optimization Plan a chance to unfold, and for another quarter of financial results to be made available; and
3. the desire for Unitholders to have more time to consider the issues and engage.

Regarding the first justification, the Court found that given the savings of holding a combined annual and special meeting was only approximately 0.1% of First Capital's revenue and that First Capital had a good track record for Unitholder turn out and engagement at past meetings held in close succession, such a justification was less compelling.

With respect to the second justification, the Court found that the Board's desire to ensure that information was put before the Unitholders about the unfolding of the Optimization Plan up to when the special meeting was called on December 30, 2022 was reasonable and supported deferring the special meeting until at least after

the 2022 annual financial statements were available, with the expectation that the financial statements would be available on or about February 8, 2023.

The Court also took issue with the third justification, stating that “absent some identified event or external factor that could better inform Unitholders’ decision making, simply waiting to see if something might happen, or that financial results might improve in the first quarter of 2023 is not a reasonable justification to delay the special meeting to await those results”.

The Court was also concerned with the prejudice to both the requisitioning Unitholders and those who supported their proposals that may have resulted from the delayed meeting to accommodate another quarter of results, because the objective of Sandpiper (introducing new Board members to check the Board’s supervision of the Optimization Plan) would at the very least be diminished by allowing the incumbent Board to continue with the implementation of the Optimization Plan “any longer than is justifiably necessary until the special meeting is held”.

The Court was additionally unpersuaded by the third justification of the Board, as the further information that the Board intended to provide to Unitholders was the first quarter 2023 financial statements. These financial statements would not be available until early May and could not have been included in the meeting materials for the May 16, 2023 meeting date. As a result, the Unitholders might not have had the additional financial information that the Board suggested would enhance their decision-making and engagement with very much time to spare in advance of the May 16, 2023 meeting date.

Ultimately, the Court found that two of the three principal reasons for the selection of the May 16, 2023 date for the special meeting were not compelling: (i) the cost and distraction of two meetings and (ii) the additional time to consider further financial results.

The Court found the third justification, which the Court characterized as “unspecified steps or events that might transpire and would be reflected in the first quarter financial results”, to be “too vague and speculative to be meaningful”. Additionally, the Court found that the prejudice that this justification posed in the potential for a diminishment of the objective of the Requisition (to change the Board oversight of the Optimization Plan) had not been considered or mitigated by the Board. To this end, the Court found that such prejudice could have been mitigated if First Capital had agreed to the Undertaking, and in fact, Sandpiper would also have been content to delay the meeting for five months in such circumstances.

The Court therefore concluded that the Board’s decision to hold the special meeting five months after the Requisition resulted in an “unreasonable or unjustifiable” delay, and ordered that the special meeting be held on March 1, 2023 or as soon as possible thereafter; which in the circumstances meant that the Court expected that the meeting will be called in late March or early April 2023.

Key Takeaways

The Decision provides additional guidance to boards of directors on the framework that a court will use in assessing whether the delay between a requisition and a meeting is unreasonable. In particular, it is important that boards of directors ensure an appropriate process is followed, including that adequate time has been allotted for consideration of the requisition, and that minutes of board and committee meetings are carefully drafted to support the decision made by the board. We note that the Court was concerned that the trustees that Sandpiper was seeking to replace were present at, participated in, and voted on the resolution passed at, the Board meeting with respect to the date of the special meeting, and this appeared to impact the Court's finding to not show deference to the business judgment of the Board. This conclusion is contrary to conclusions reached in prior decisions by the Court and at least one other Canadian court and could in many cases work to the benefit of an activist by, for example, simply seeking to replace all the independent directors or the members of an already constituted special committee formed to consider a potential activist's campaign.

The Decision also makes it clear that boards of directors must consider the unique circumstances of their own entity that may render reliance on justifications for delay accepted by a court in other circumstances less persuasive. Additionally, the Decision highlights the importance of considering and addressing the potential for prejudice to requisitioning shareholders and their supporters that might arise from a decision by the board to delay a special meeting.

by [Paul D. Davis](#), [Sandra Zhao](#) and [Troy Hilson](#)

A Cautionary Note

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