

PROTECTING AGAINST SHAREHOLDER ACTIVISM IN UNCERTAIN TIMES

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The global financial crisis that began in 2008 led to a historic rise in shareholder activism. We would expect a similar increase in activism as a result of the COVID-19 pandemic, as depressed share prices and beaten down balance sheets, as well as low borrowing rates, will provide activists with unprecedented opportunities. However, we would expect that this new wave of activism would be delayed in the short term until the market stabilizes or there is more clarity on the duration of the pandemic. This reprieve in the coming months will allow companies to prepare for coming campaigns.

Limited Activism in the Near Term

In the near term, we anticipate that activists will struggle to capture the attention of shareholders who are otherwise consumed with news of COVID-19 and its public health and economic consequences. Corporate governance, executive compensation, board performance, relative financial results, traditional approaches to unlocking shareholder value and other items that are typically the subject matter of activist campaigns are unlikely to spark the interest of most shareholders in the fog of a global pandemic.

In addition, a prevailing sense of uncertainty, about the duration of the pandemic, the extent of stay-at-home orders, the extent of government support of ailing industries, the long-term impact on consumer behaviours, and the availability of capital for companies seeking liquidity, is likely to be a drag on activist enthusiasm and perhaps on the ability of activists to access capital for additional investments. Furthermore, dramatic market volatility has left activists focused on current valuations and uncertainty surrounding the financial prospects of portfolio companies, leading to a “wait and see” approach.

Attractive Opportunities as the Storm Passes

While markets slump, activists are presented with an opportunity to increase holdings in potential target companies. Furthermore, the delay in delivering financial results and postponed shareholders’ meetings give activists more time to fine-tune their campaigns.

As the initial wave of uncertainty passes and the market and economic conditions stabilize, a large contingent

of well-funded activists will be positioned to launch campaigns against vulnerable targets. Some activists may even attempt to present themselves as “white knights” possessing the capital and expertise to save the company in its time of crisis.

Strategic Considerations

To counter these risks, companies should consider and implement strategic initiatives to protect against unwelcomed shareholder activism. By necessity, the actions of a potential target company are reactive. However, a number of strategic steps may be taken to prepare the company.

1. Communicate with shareholders

It is critical to address shareholder concerns in a timely manner. Most companies today engage in various forms of investor relations activities. The more in-depth or formal investor relations are, the more likely management will identify “red flags” early and proactively address them.

2. Follow best practices in corporate governance

Institutional Shareholder Services Inc., Glass, Lewis & Co., LLC, Ontario Teachers' Pension Fund, Canadian Pension Plan Investment Board and Canadian Coalition for Good Governance are all organizations that produce voting guidelines. Corporations should seek to follow such guidelines and best practices, as these organizations have significant influence on proxy contests and institutional shareholders tend to follow their voting recommendations.

3. Board succession and renewal plan

The board of directors or governance committee thereof should ensure that the directors have the knowledge and skills necessary to enhance the long-term performance of the organization. The board should establish a board selection profile with the general qualifications to be used in the identification of individual candidates as well as the key qualifications and core competencies required for the board as a whole. This profile should be the basis for ongoing analysis to ensure that the need for future board appointments is known and addressed. It will always be preferable for the company to itself address weaknesses with the composition of its board, rather than have an activist do so.

4. Be alert to accumulations of ownership positions

A shareholder accumulating a company's shares is usually good news; however, this could be an indication of an impending take-over bid or a proxy fight. Be aware of increasingly large ownership positions or the formation of “joint actors” in press releases and early warning report filings announcing the beneficial ownership of, or power to direct and control voting shares of the company that constitute, 10% or more of a

class of its outstanding shares. In addition, the historic activity of new shareholders should be researched, with a focus on whether or not they have an activist track record or business plan.

5. Watch for requests from shareholders

Activist shareholders may make requests of the company that tip their hand, including: (a) transferring share ownership from beneficial to registered, which facilitates meeting requisitions; (b) a request for a shareholder list and/or access to the company's corporate records; and (c) a request for a list of non-objecting beneficial holders.

6. Monitor voting activity

In the weeks leading up to a shareholders' meeting, monitor the number of proxies returned to the transfer agent and any changes in patterns from prior years. In addition, watch for completed proxies where the beneficial owners have named themselves as their own proxy appointees, and for the nomination of one individual as a proxy appointee for a number of proxies, as that could suggest the presence of an activist group.

7. Implement available legal protections

Certain structural defenses are likely to help, including: (a) adopting advance notice corporate by-laws that require timely notice to propose nominees for directors; (b) increased shareholder quorum requirements; and (c) adopting a shareholders' rights plan.

8. Establish a proxy defense team

It is important to either establish a proxy team well in advance of a proxy fight or to have a clear idea as to the make-up of such a team. Team members may include:

- Key decision makers and internal spokespersons: persons within management and the board of directors who have influence among shareholders to participate in the proxy fight process on behalf of the company. It may also be appropriate to provide communications training to key company spokespersons.
- Outside counsel: essential because in addition to legal strategic advice being a key to winning, there are many legal issues that are not obvious to those who do not practice in the field.
- Transfer agents: they are experts in the proxy fight realm and can be of great assistance if they are involved early on.
- Proxy solicitation agents: their knowledge and strategic advice can also be important in soliciting proxies successfully, particularly with respect to retail investors.
- Public relations consultants: they are critical partners in waging a successful campaign, particularly in

significant fights with large public companies.

- Government relations advisors: in heavily regulated industries, these are key advisors.
- Financial advisors: investment bankers or other financial advisors may be helpful if issues arise as to value or the appropriateness of various transactions.

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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