

SHAREHOLDER ACTIVISM: COMING TO A COMPANY NEAR YOU

Shareholder activism has long been a reality in the United States but, like many trends, has been slow in making it big in Canada. Well, the time has finally come. Shareholder activism has arrived

By Sandra Rubin

It was one afternoon in March when David Weinberger and John Ciardullo from the Toronto office of Stikeman Elliott LLP placed a call on behalf of Eugene Melnyk, one of their clients. The founder of Biovail Corp. had recently retired from the company he ran for the better part of two decades. He was very unhappy with the stock's sharp drop in price.

Melnyk wasn't prepared to sit idly by and do nothing. He was prepared to go to war with Biovail's board if that's what it took.

The Stikeman lawyers called Wes Hall, president and CEO of Kingsdale Shareholder Services.

Kingsdale, along with competitors such as Georgeson Shareholder Communications Canada and Laurel Hill Advisory Group, are "proxy solicitors" who, among other things, provide frontline tactical advice on disputes between companies and shareholders. And, boy, have they been busy.

When they got Hall on the phone, they wanted to know whether he was available to help Melnyk shake things up.

By then, everyone had read the February 28 letter Melnyk sent the board outlining his discontent with his successors in Biovail's management. The company's stock had dropped in the order of 50 per cent within weeks of him leaving. Melnyk said in his letter, which was published on the news wires, that he was looking at a range of strategic alternatives, from forming a group to buy out other shareholders, to changing the board of

directors, to completely dumping his 11 per cent stake.

Hall did a conflicts check and got back to the Stikeman Elliott lawyers to tell them he was good to go. He was quickly put in touch with Bill Braithwaite, a senior M&A lawyer at Stikeman Elliott who would lead the legal team. Once they'd spoken, it didn't take very long for Hall to get a phone call from Daryl Boyce, Melnyk's right-hand man.

Boyce came in to the proxy solicitors' offices and met with the prospective team to see if they were "Eugene ready," as people close to Melnyk like to joke. They kicked around a few ideas and Kingsdale made a couple of recommendations about strategy and tactics. Boyce liked what he heard. He asked Hall and Wayne Bigby, Kingsdale's executive vice president, to fly in to Ottawa to meet with the man himself to discuss approach and tactics.

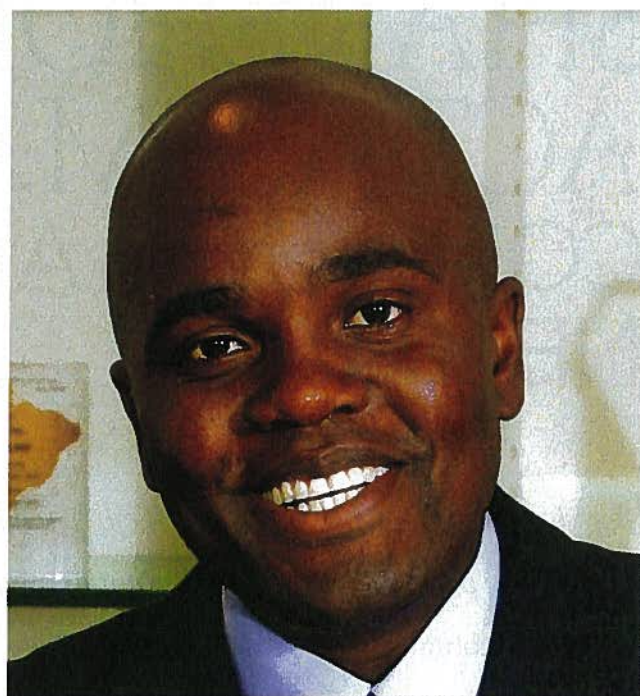
They did and had "a great meeting talking about strategy" as Hall tells it. The vibe was good. Melnyk invited Hall and Bigby to join him that night in his box at Scotiabank Place to watch game four of the first-round playoff series between the Pittsburgh Penguins and the Ottawa Senators, the National Hockey League team he owns.

The high of the earlier meeting must have dampened somewhat when the Senators lost 3-1, eliminating them from the playoffs. The four-game sweep was seen as sweet revenge for the Penguins, who were knocked out of last year's playoffs by the Senators.

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Noralee Bradley; Osler, Hoskin & Harcourt LLP



Wes Hall; Kingsdale Shareholder Services Inc.

Melnyk was determined not to be knocked out of the boardroom battle.

He wasn't so much looking for sweet revenge at Biovail as the chance to make changes to the team. When Hall and Bigby left Ottawa to fly back to Toronto on the morning of April 17, it was with a firm commitment they would be engaged. The plan was for a proxy fight to install a new slate of directors. Melnyk had just joined the ranks of Canada's activist investors.

Hall has some advice for Canadians: Get used to it.

"I think shareholder activism is the wave of the future in this country. Yes, we've seen it in the US but it's really coming here. And it's coming like a whirlwind."

In Canada, outside the hockey rink, we're sometimes perversely proud of our reputation for politeness, especially when playing in public. That may be why proxy fights have been something of a rarity. Wall Street has its Carl Icahns and California Public Employees' Retirement System (CalPERS) but Canada's financial community has never been much for protracted public slanging matches.

Bay Street has long preferred to fire its salvos behind closed doors. The unwritten credo has long been if you don't like what a company is doing, don't make a fuss — just vote with your feet.

Up until a few years ago, the most recognizable public face of shareholder activism in Canada was either Bob Verdun or Yves Michaud, two retail investors many on the Street considered to be gadflies.

Not any more. But there hasn't been a revolution in shareholders' rights in Canada so much as a Quiet Evolution, a creeping willingness to stand up and be counted. In 2003, there were just three proxy battles. Last year there were 16. By August of this year, there had already been 18 contests as Canada was smashing through to another record.

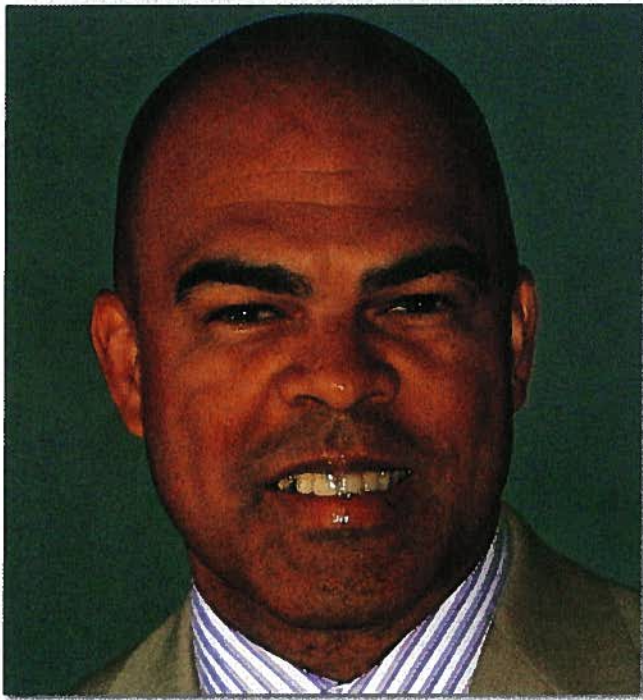
Braithwaite calls it "a waking up of Canadian shareholders, frankly. People are becoming more aggressive and more willing to spend money in order to exercise their rights. Shareholders have been sleepy, generally, for years."

They are awakening to a whole new day, says Debbie Weinstein, an M&A and securities lawyer and co-founder of Ottawa-based LaBarge Weinstein Professional Corporation. She says there has been profound change in the last five years and anyone who doubts it need only look at the number of service firms built up in the area of shareholder activism — proxy solicitors, specialized PR companies and investor relations specialists.

Weinstein was fresh off the Zarlink Semiconductor proxy contest in which she'd been advising a concerned shareholder when she was first interviewed for this story.

She says one thing that really hit home in that campaign was the extent to which corporate governance advisory firms like RiskMetrics Group (formerly Fairvest in Canada) — as well as institutions that take public positions on takeovers and proxy contests — have suddenly become a force to be reckoned with. "Not only are they players, they've become lynchpins in how

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Brad Allen; Laurel Hill Advisory Group



Jeff Benson, QC; Benson Myles

things turn out,” she says. “In our case, RiskMetrics put out a report in support of management that may have killed our bid. We lost, and certainly with their support – or even their neutrality – we probably would have won.”

Here’s the kicker. As long as there have been formal stock markets there’s been inept management running a certain percentage of companies, and investors exasperated at underperformance.

So why is it that so many people are suddenly dropping the gloves?

If you’re looking at why you have to start with the gush of corporate scandals, the Enrons and Worldcoms, that gave rise to the current governance wave, says Roy Shanks, president and chief operating officer of Georgeson Shareholder Communications Canada.

“We also had our own issues in Canada like Bre-X Minerals, which changed a lot of people’s thinking,” says Shanks, who was part of the team advising Biovail in its proxy contest.

“What stands out for me is the way big institutional investors, the big names we all know, are now stepping forward and saying, ‘This transaction is not correct’ or disagreeing with the terms of a merger or an offer. They used to just vote with their feet but that’s not happening as much. I’ve done somewhere between 50 and 75 of these campaigns over my career. There’s a new activism out there.”

Wes Voorheis, a principal of Toronto-based Voorheis &

Co. LLP, says you also have to look at shareholder activism in the United States if you want to figure out what awakened Canadian institutions.

Voorheis should know. He’s been at the cutting edge of this area since leaving Davies Ward Phillips & Vineberg LLP to found his new firm in 1995. Voorheis and his partner Mike Woollcombe advise activist investors, typically large institutions. Let’s just say upsetting boards on behalf of their clients is their specialty.

Voorheis, a product of Davies in the 1980s and 1990s, has been involved in more than his fair share of board dust-ups from YBM Magnex International Inc. and Stelco Inc., to Hollinger Inc., Atlas Cold Storage and Coventree Inc.

He says, “It’s a whole different ball game today.

“A decade ago, there was really no one prepared to be out front and lead the charge,” he says. “The biggest voice in Canada was Claude Lamoureux at Ontario Teachers’ [Pension Plan], but the reality was – and I have the highest regard for him and Teachers’ – that they were very reluctant to take action. They cajoled through verbal pressure but they didn’t, to my knowledge, take any proactive steps to take over boards or push people around.”

Where Lamoureux and Teachers’ may have been squeamish, he says, there is a new breed of shareholder activist that is not.

“They are mostly US hedge fund guys – some of whom have moved here and some of whom invest here from the US – who have a totally different mentality and approach. There are lots of guys around now who will push. They’re still learning the

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ropes a little bit, but the number of players who are prepared now to be out front and take the adverse publicity, well, I can't tell you exactly how many but there are many, many, many of them.

"Most of the guys who do it today do it with funds they invest for themselves, they're hedge funds or private equity funds. Once you've done a few of these you know how to do it, and so away you go."

But they wouldn't be able to do what they do were it not for amendments to the *Canadian Business Corporations Act* and corresponding provincial Acts in late 2001, expanding shareholders' ability to communicate with each other without triggering proxy solicitation rules. Before that, almost any communication could be deemed to be a solicitation, which would oblige the dissenting shareholder to prepare and mail requisite proxy documents to all the company's shareholders — an expensive proposition.

Today, shareholders can make a public announcement about their voting intentions at the annual meeting by issuing a press release or even taking out an ad. Stockholders are also allowed to communicate with up to 15 other shareholders for the purpose of obtaining support for shareholder proposals or organizing a proxy solicitation.

"While a lot of us thought it was entirely OK to call another shareholder up and say: 'What do you think of those guys?' there were some around who would advise the shareholders not to talk because you could never quite tell whether that conversation was a statement of your views about management as opposed to a solicitation of proxy," Voorheis says. "Conversations between shareholders were very stilted. Some institutions took a very determined view and wouldn't talk to you at all. You had to try and manoeuvre around and guess what they thought.

"But today I can get a shareholders' list from Bloomberg, and pick the 15 largest and call them up and say: 'I hate these guys, I want to kick the board out, I'm going to put forward my own candidates and, if I do that, will you vote in favour?' Institutional investors have such large interests that we find we can talk to 15 people and know where the majority of the stock is. You will know you're going to win before you go public. By the time the board gets wind of the fact it's facing a proxy battle, it's often already too late."

That wasn't the case with Biovail.

Put Biovail aside for a moment longer. The larger statistics don't necessarily bear that out. Kingsdale, which has tracked 90 Canadian proxy contests dating back to 2003, has found about 50 per cent are successful. But everyone who plays in the share-

holders' rights space in Canada expects both the frequency and the success rate to go up.

Penny Rice, vice president advisory services at Laurel Hill Advisory Group, says dissidents today have a range of mechanisms at their disposal that people unhappy with a board five or 10 years ago probably never dreamed of.

"The ability to communicate with shareholders has greatly increased," she says. "For instance, both sides usually have a website with all their material that allows you to have a quick and easy and inexpensive way to communicate the most up-to-date information. A central web page allows you to create a video and other more visual effects, so where a shareholder might not be willing to read a great big long info circular, they might be willing to listen to a 10-minute video on your website.

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Laurel Hill itself may be living testament to faith in shareholder activism as a growth industry. Glenn Keeling left a senior management position at rival Georgeson at the start of this year

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to join the new company's North American start-up.

The young firm completed its first Canadian transaction on January 17 and there's been no looking back, Keeling says. As of August, the company had already worked on 15 or 16 campaigns and he expects that last number to double by the year's end.

"It's a well-known fact that Canada's the easiest place on the planet to take a company over because we have a regulatory infrastructure that allows someone to come in, swallow up a small amount of stock, and either mount an attack to get representation on the board or an out-and-out takeover of the business," he says. "In the United States, they have a just-say-no defence. We don't have that here.

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"So you see hedge funds like Crescendo Partners love it here. They absolutely love doing business in Canada. You can also stay hidden in Canada until you reach 10 per cent, which is different from the 5 per cent rule in the US."

Brad Allen, Laurel Hill's senior vice president, says activist investors who feel management is doing a poor job running the company have also begun to twig to the fact that proxy fights are cheaper than takeover bids. That's huge.

"With the current credit conditions and the overall market economy, people are finding that instead of launching a takeover bid for a company at a premium of 20 per cent to 40 per cent, it's cheaper and can be just as effective to replace directors and gain control of the board," says Allen. "And you don't have to hold a lot of stock to bring about that change. That's why we're seeing a lot more proxy fights and expecting to see even more."

If Allen and Shanks and all the other oracles are right, that's good news for Canada's corporate law firms.

Proxy fights and takeover bids aren't exactly cheap.

If you've read all the press reports about Melnyk over the years you know he's not a man to do things in half measures.

Within weeks of deciding to challenge the board, a well-oiled machine was in place. From the sound of it, it's the new template for modern-day corporate combat in Canada. There were websites, television ads, glossy brochures and even a UBS memory stick for shareholders to plug into their computer that launched a video explaining why Biovail was "broken" and what could be done to "fix it."

"There were a whole lot of things done in this proxy fight that had never been used in the history of proxy fights in this country," says Hall, who was advising Melnyk. "It really set the bar for a top-shelf, high-level, no-expense-spared proxy campaign."

Braithwaite, Melnyk's lead lawyer at Stikeman Elliott, agrees, saying, "Clearly the Biovail situation set the high-water mark for these battles. The resources dedicated both by the dissident and by the company was, as far as I'm aware – and I've done a number of these – unprecedented."

No one working on Biovail (for either side) was willing to speculate how much Melnyk spent in his quest to replace the board. But people familiar with how much such campaigns cost estimate he spent \$5 million or more. It has to be assumed that Biovail responded in kind.

As everyone knows by now, there were steep hairpin curves in the Biovail battle. In the end, Melnyk dropped his attempt to get a new slate of directors elected, and shareholders affirmed the existing board.

Here's the rub.

When Melnyk withdrew his 18 million shares right before the original meeting, there were not enough shares represented to meet the 51 per cent required for a quorum. That says at the end of the day, despite the likelihood north of \$10 million was spent on this campaign – despite the sophisticated tactics, the glitz and the gimmicks – when the vote was held, a great many shareholders simply sat on their hands.

Investors representing two thirds of Biovail shares didn't even bother to vote.

Biovail was clearly concerned enough when the meeting

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was rescheduled (after considerable legal wrangling) to send its stockholders a letter imploring them to vote. "Every vote is important The more proxies that are submitted, the clearer the way forward for Biovail."

The appeals worked, or maybe it was all the news coverage, but more than 75 per cent of shares were voted the second time around. However, the low turnout in the original vote in such a high-profile proxy campaign has not gone unnoticed.

"I think what was happening initially is that people were getting frustrated with this war," says Wendy Kelley, Biovail's senior vice president, general counsel and corporate secretary, pressed to explain what it might mean. "So what it says to me is I don't know how much repeated efforts add value."

Hall, who was advising Melnyk, agrees, saying, "If a stock has been beaten up for a long time, investors just write off their investment emotionally. So when they see a proxy, they just put it in the recycling bin."

But Kelley also believes companies involved in special situations are attractive plays for investors looking for higher risks and rewards, so their shares turn over more quickly. As a result of the large turnover, information mailed by the company doesn't get to the people who end up voting the shares.

That may well be true but just part of the story.

With so many people predicting awakening shareholder activism will lead to more frequent – and more in-your-face – public campaigns, a niggling concern is whether investors bombarded with information will simply succumb to shareholder fatigue.

There's a lot at stake on the answer.

Noralee Bradley, a corporate partner in the Calgary office of Osler, Hoskin & Harcourt LLP, says low voter turnouts – whatever the reason – can be advantageous for the activists and dangerous for the company.

“When you're dealing with low participation in a shareholder meeting, if you have 40 per cent showing up to vote, you only have to get 20 per cent to support a change,” she says. “It's usually not 50 per cent of outstanding shares that is required, but rather 50 per cent of the shares that show up to vote at that meeting, either in person or by proxy. So as a shareholder, you if could mobilize 20 per cent behind the scenes and show up in person to vote, you can get there with a very low actual percentage.”

The best way to defend against a very public, expensive and possibly disruptive war, say Bradley and others, is to avoid it at all costs whenever possible.

Bradley says her best piece of advice for publicly traded companies is to keep their friends close, and their shareholders closer.

“It's not enough to know who your shareholders are,” she says. “You've got to develop an understanding of who the decision-makers are so you know who to be talking to. You need to know what their objectives are in terms of holding this investment, how long they plan to be in and what their views are on corporate strategy and decision-making. That should at least allow you to know where your votes may be, and your support.”

Braithwaite says many corporations are laying the foundations for a defence when times are good, in order to be prepared for an ambush.

“Most public companies now are doing a much better job of being prepared both for an approach by a potential buyer or someone launching a proxy battle,” he says. “I think most have preparedness manuals, which they wouldn't have had years ago, and they work with their outside counsel who advise them to get ready so if someone does lob in a bear-hug letter or a request for representation on the board, they aren't caught trying to figure out what to do.

“There should be a strategy in place for developing a working team and potentially retaining advisors and striking a special committee. You have to be aware these situations are part of the

company's risk profile and, like every other risk you're exposed to, you try to manage it.”

Jeff Benson, QC, a corporate partner and director of Benson Myles in St. John's, NL, says he advises companies to take it even a step further.

“It's probably important, especially for the larger public corporations, to have somebody fairly senior in a management position or someone who reports to them do a regular review of share purchases and trends, and to analyze who's buying and who's selling,” he says. “Check their backgrounds and affiliations of groups acquiring shares, check their track records as well to see if

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they do have a history of shareholder activism of any sort.”

Benson says it's equally important for companies to know themselves — keep an eye on margins and operational inefficiencies so they can anticipate any problem. He recommends regular financial modelling, and says it's key to make sure executive compensation is properly aligned with shareholder value and performance “because that's a real flashpoint.”

Boards can also discourage surprise shareholder attacks by making sure there are long notification periods in the bylaws or articles of incorporation, and provisions for the board to replace directors in the event of an unexpected vacancy between annual general meetings without the need to call a shareholders' meeting. They can also make sure a super-majority of 75 per cent of shares is required to amend bylaws or articles instead of the more common simple majority of more than 50 per cent.

“You can do everything right but you still can't always avoid a fight,” Benson says. “The company has to keep the best interests of all its shareholders in mind and can't always accommodate the wishes of one group. But at the end of the day, a little corporate activism can go a long way to addressing shareholder activism.”

Sandra Rubin is a freelance legal affairs writer.