Requisitioned meeting breaks deadlock

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A deadlocked board of directors, talk of a “public flogging”, and a court reluctant to intervene. The case of *Goldstein v. McGrath* is a colourful recent example of a requisitioned public company shareholders’ meeting, with the twist that the requisitioning shareholders were represented by or aligned with three of the company’s six directors.

The decision provides three helpful reminders for boards, shareholders and their advisors:

1. The right of shareholders to requisition a meeting can be a powerful tool, especially in the context of junior public companies.
2. Courts are generally reluctant to exercise their authority to call shareholders’ meetings.
3. A court will need strong evidence that an incumbent chair may engage in impropriety before appointing an independent chair for a shareholders’ meeting.

Facts

The six directors of Photon Control Inc., a TSX Venture Exchange listed technology company (**Photon**), were deadlocked on a number of matters.[1] A group of shareholders who represented more than five percent of Photon’s shares (the **requisitionists**) exercised their right to requisition (i.e. demand) a shareholders’ meeting under the British Columbia *Business Corporations Act* (the **BCBCA**).[2] Two of the requisitionists were members of the board of directors of Photon and were allied with a third director. The purposes of the meeting were to remove the other three directors, including one who was also the CEO of Photon (the **incumbents**), to fix the number of directors at five, and to elect two new directors.

The requisition provisions in the BCBCA authorize requisitioning shareholders to call a meeting of shareholders if the company’s board of directors does not do so within 21 days after receiving a valid requisition.

As a result of the deadlock on its board, Photon’s directors did not call a shareholders’ meeting in response to the requisition.

The incumbents, anticipating a proxy fight for which they would require advice, made payments from corporate funds to retain lawyers who would advise them on discharging their duties to Photon. They also retained a proxy solicitation firm. Five days later, the requisitionists applied to court for, among other things, an order that those funds be repaid to Photon, on the basis that the payments had not been approved by the board. The funds were duly repaid within a few days of this application.

The incumbents then asked the court to order a shareholders’ meeting under section 186 of the BCBCA (discussed below). They also requested the appointment of an independent chair for the upcoming shareholders’ meeting.

Both sides were asking for a shareholders’ meeting, so why the dispute? In a word - money. The incumbents argued

that corporate funds should be used to pay the reasonable expenses of both sides in preparing proxy materials and soliciting proxies from shareholders, to a maximum of $500,000 each.[3] The requisitionists were of the view that no corporate funds should be advanced for these purposes prior to the meeting.

These positions seem to reflect both the financial resources of the two sides and the relative confidence each had in its ability to win a proxy fight. Absent a court order that corporate funds be used to pay both sides' expenses, the party that lost the vote at the meeting would be faced with paying its own expenses, while the successful group would be entitled to have its reasonable expenses reimbursed.

The requisitionists, who included two significant shareholders with the apparent ability to finance a proxy fight, were in a stronger position on both counts.

Issue 1: Should the court order a meeting?

Under Section 186(2) of the BCBCA, a court may order a shareholders' meeting, and give directions as to how such meeting should be called, held and conducted, in three circumstances:

a. if it is impracticable for any reason for the company to call or conduct a shareholders' meeting in the manner required under the BCBCA or the company's constating documents,
b. if the company fails to hold a shareholders' meeting in accordance with the BCBCA, the applicable regulations or the company's constating documents, or
c. for any other reason the court considers appropriate.

At the conclusion of the hearing, the Court declined to intervene, finding that the incumbents were attempting to circumvent the requisitionists' exercise of a "clear statutory right". Citing two Ontario decisions, [4] the Court ruled that courts should only intervene to order shareholders' meetings in exceptional circumstances.

The Court went on to hold that, even if it were to order a shareholders' meeting, each side would be responsible for its own costs. Citing cases from Québec[5] and British Columbia,[6] it held that when a board of directors is evenly split, each side stands on the same footing as individual shareholders who must fund their own proxy solicitations.

Issue 2: Should the court order an independent chair for the meeting?

Photon's constating documents included a common provision that the chair of the board is entitled to chair all meetings of shareholders. The incumbents argued that the past conduct of the chair (a requisitionist) led to a reasonable apprehension of bias. Such conduct included the chair allegedly telling one of the incumbents that the requisitionists would destroy his reputation, discredit him, give him a (presumably figurative) "public flogging", and force his departure from Photon.

However, the Court held that an apprehension of bias is not enough to merit a court-ordered independent chair. Citing a Supreme Court of Canada decision,[7] the Court held that, in order to mandate the appointment of an independent chair, it required evidence of the potential for impropriety by the chair at the meeting. It went on to find that personal attacks and "occasional intemperance" are not sufficient. As there was no other evidence of potential impropriety, the Court declined to grant the requested order.

The fallout

The Court's decision in this case effectively obviated the requirement for the requisitioned meeting. Shortly after the Court's decision, the incumbents resigned from the board of Photon. Two new directors were then appointed by the requisitionists to fill the vacant board seats, one of whom was also appointed CEO. The company then called an AGM and all of the requisitionists' nominees were elected.

Why this case is important

Board strategy and the power of the requisition right

Requisitioned shareholders' meetings are often called to replace some or all of the directors of a company. If the requisition is valid, it will usually be in the interests of the incumbent board to call the meeting in accordance with the requisition provisions of applicable corporate legislation, rather than allow for the requisitioning shareholders to do so. By calling the meeting itself, the board retains control of the meeting, the company's solicitation of proxies, and the contents of the management proxy circular.

In the Photon case, the board was unable to agree on the proper course for calling and holding a meeting. The incumbents made a reasonable choice in applying for a court-ordered meeting in which both sides' expenses would be reimbursed by the company. Another option may have been to ask the Court to order the company to prepare a neutral information circular and a universal proxy.

In another British Columbia decision, *Xemplar Energy Corp. (Committee of Board of Directors) v. Tam*,[8] as in the case at hand, the backdrop included a requisitioned meeting and a split board. In Xemplar, however, the board had called a meeting on receipt of the requisition. On application by a special committee of the board that had been tasked with calling and holding the meeting, the Court made an order under section 186 of the BCBCA as to the conduct of the meeting, including the date on which it would be held and the membership of the special committee. The Xemplar case was not cited in the Court's decision in the Photon case.

The Photon decision highlights the potency of the requisition right, particularly for junior public companies. On receipt of a requisition, directors have a maximum of 21 days to assess the validity of the requisition, obtain and consider legal advice, potentially try to negotiate with the requisitionists, and call a shareholders' meeting, which requires the preparation and mailing of an information circular. If the directors fail to call the meeting within 21 days, the directors risk ceding control of the meeting procedure and materials to the requisitionists, and increase the risk that their expenses won't be paid from company funds. In many cases, particularly among small-cap companies, it is not difficult for activists or dissidents to organize support from holders of five percent of the shares.

The case in context of recent shareholder activism

The Photon decision is an example of a trend toward a greater role for shareholders in setting the corporate agenda of public companies in Canada. The recent Ontario appellate court decision in *Koh v. Ellipsiz Communications Ltd.* is another instance of a shareholders' meeting that was successfully requisitioned despite resistance from the company's directors. A third example is the advent of proxy access bylaw proposals in Canada, which allow shareholders to include director nominees in a company's circular and form of proxy. [9]

Given these trends, as well as changes to the take-over bid rules made last year (see *Canadian Securities Administrators amend take-over bid rules*), shareholders' meetings appear to be assuming a more significant role in contests for control of public companies in Canada.

This article was co-authored by Ray Power, Summer Student, and Daniel McElroy, Knowledge Management Lawyer, both in Dentons' Vancouver office.

References

[1] First and foremost, they disagreed over the appointment of Photon's Chief Executive Officer. Part of the background relates to the termination of the former CEO (who concurrently resigned as a director), the resignation of the former chair at the request of Photon, and the resulting vacancies on the board. These changes related to an unauthorized transfer of $4.5 million to a company in which the former chairman "had an interest". This dispute, which is referenced in the pleadings, was settled subsequent to the date of the Court's decision, as noted in Photon's public disclosure.

[2] This right of shareholders holding at least five percent of a company's shares to requisition a meeting is common to most business corporation statutes in Canada, with some technical variations among them.

[3] The Court's reasons for judgement indicated that the incumbents estimated the expenses of each party to be $1.3 million, and did not acknowledge the $500,000 cap on the amount to be reimbursed. This

appears to be a factual error in the decision, but it seems unlikely to have had a significant impact on the outcome.

[4] *Airline Industry Revitalization Co. v. Air Canada*, 1999 CanLII 15075 (ON SC) and *Russian Orthodox Church Outside of Russia Inc. v. Protection of the Holy Virgin Russian Orthodox Church (Outside of Russia) in Ottawa, Inc.*, 2002 CanLII 3570 (ON CA), [2002] O.J. No. 4698.

[5] *Re Canadian Javelin Ltd. And Boon-Strachan Coal Co. Ltd. et al.*, 1976 CanLII 1249 (QC CS).

[6] *Pala Investments Holdings Ltd. v. Bristow*, 2009 BCSC 680 (CanLII).

[7] *Blair v. Consolidated Enfield Corp.*, 1995 CanLII 76 (SCC), [1995] 4 S.C.R.

[8] 2012 BCSC 2153 (CanLII).

[9] Proxy access proposals were put forward at recent meetings of Toronto-Dominion Bank and Royal Bank of Canada. The TD proposal was approved, while the RBC proposal was not. The voting results of the respective meetings are available here and here, (item 10 in each case).

Your Key Contacts

Gary R. Sollis
Partner, Vancouver
D +1 604 443 7130
gary.sollis@dentons.com