Cassels

Outlook 2020: Guidance for Special Committees and Disclosure Obligations - A Catalyst Case Study

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In connection with its responsibility to protect investors by ensuring that regulated companies are meeting their disclosure obligations, the Ontario Securities Commission ("OSC") released a decision this year which emphasized proper disclosure of related party transactions.

The purpose of disclosure of related party transactions is to ensure that shareholders (and particularly minority shareholders) are adequately informed and protected from abusive or unfair conduct that can arise in such circumstances. The OSC has now confirmed that this protection extends to disclosure obligations for special committees, whether or not the special committees themselves are legally required.

In *Re The Catalyst Capital Group Inc.*,[1] the OSC provided direction regarding special committees and the standard for disclosure required under Multilateral Instrument 61-101 *Protection of Minority Security Holders in Special Transactions* ("MI 61-101"). Essentially, the OSC determined that where a special committee is formed in the context of a transaction with substantial conflicts of interest, whether legally required or not, that committee will be held to the same standards as one that the company was legally obligated to form.

Boards of directors and their advisors are aware that special committees can and often should be created, properly mandated and advised, and involved in a transaction's early stages, so that they can effectively perform their role of protecting shareholders and assisting the board from the outset. Indeed, decisions made by a board without the benefit of necessary input from a special committee may later be rendered ineffective.

Significantly, management information circulars must include all information that is "important to enable an investor to make an informed decision." The OSC has now interpreted this information to include full disclosure about the special committee's processes, including any restrictions and/or limitations, because this information is considered material to shareholders' decision-making. Any failure to do so may lead to orders that sufficient disclosure be provided, and consequent delays in holding shareholder meetings.

The Catalyst Decision

In December 2019, private equity firm The Catalyst Capital Group Inc. ("Catalyst") complained to the OSC about alleged abusive or coercive conduct and disclosure deficiencies in connection with a proposed plan of

arrangement (“Arrangement”) that would take Hudson’s Bay Company (“HBC”) private. The proposed Arrangement involved a group of shareholders that together owned 57% of HBC voting shares, and included a holding company owned by HBC’s Governor and Executive Chairman and his family.

The OSC granted standing to Catalyst to bring the application under section 127 of the *Securities Act* (Ontario), a power typically reserved for OSC staff. The decision to grant standing was based on several factors, including in this instance that the application raised fundamental securities regulatory issues involving compliance and minority shareholder protection.

The instrument of primary application was MI 61-101, the purpose of which is to protect minority shareholders from abusive or unfair conduct that can arise when related parties are involved in transactions. MI 61-101 requires enhanced disclosure, an independent valuation of the common shares including an assessment as to fair market value, and approval of a majority of the minority at a shareholders’ meeting.

In *Re The Catalyst Capital Group Inc.*, the OSC found that the requirements of MI 61-101 were not met and granted a temporary cease-trade order, required provision of additional disclosure, and postponed the special meeting of shareholders. In its written reasons, the OSC addressed a number of important issues that arise in the context of business combinations while providing important guidance to companies on the timing, formation, and role of special committees, and on disclosure requirements, including those that apply to transactions with significant conflicts of interest.

The Timing, Formation, and Role of Special Committees

In transactions that involve shareholder approval, such as the proposed HBC transaction, special committees are not legally required. However, where a special committee is established, the OSC determined that it will be held to the same standard as if it had been required by law: the special committee should have a robust process regardless of whether it is legally required, or not.

The OSC emphasized the advantage of a special committee’s involvement in a transaction’s early stages. Decisions made without its input can later render the committee unable to fulfill its important role – namely, considering the interests of security holders and assisting the board in deciding whether to recommend the transaction. Therefore, it is critical that the board and committee not be bound by early decisions or negotiations that occurred before special committee involvement.

In this case, the HBC board of directors initially mandated the special committee to oversee the sale of European real estate holdings. Its scope was later expanded to include the Arrangement. The OSC found that the HBC special committee was not properly mandated early enough in the process and speculated that its lack of involvement in early decisions and negotiations, at which time critical issues were being addressed, compromised its later efficacy. Given the special committee’s lack of involvement in what the OSC considered to be “critical issues,” the OSC concluded that the special committee was unable to

consider alternative options, seek independent legal advice, or negotiate terms that were more favourable to minority shareholders. Further, the OSC observed that it could not know how these deficiencies affected the per-share price offered to minority shareholders.

Disclosure Ordered about the Special Committee Process

The OSC held that, because of the influence it would have over investors' voting decisions, "disclosure of [the special committee] processes and the basis for its recommendation should be subject to the same disclosure standards in a management information circular that would apply if a special committee was required."[2] The standard of disclosure in respect of the committee therefore remains "what is important to enable an investor to make an informed decision" and the same level of scrutiny will be applied. In finding that this standard was not met, the OSC ordered additional disclosure regarding several critical aspects of the special committee's activities.

Further Disclosure Ordered

The OSC also found that the standard for disclosure under MI 61-101 was not met in respect of other aspects of the Arrangement. Accordingly, the OSC also required further disclosure about (1) the property valuation, including limitations of appraisals, the assessor's opinion of appraisal conduct and the effect of this information on the valuation and fairness opinion; (2) benefits that would accrue to the directors and officers as a result of the Arrangement, citing that this information was material for minority shareholders to consider; and (3) tax benefits that would accrue to the majority group of shareholders following the Arrangement.

Looking Forward

Companies must remain aware of the risks they face when creating a special committee, even when they are not legally required to do so. Where it becomes apparent that a Board's consideration of a transaction may raise issues as to a conflict of interest, it should form a special committee as soon as possible (and as soon as conflicts of interests arise in a significant transaction).

Once formed, a voluntarily created special committee will be held to the same disclosure requirements as if it had been legally required. Accordingly, special attention should be paid to the requirements for mandatory special committees. Where disclosure requirements have not been met, sufficient disclosure may be ordered, which could delay shareholder meetings or cause other disruptions.

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[1] 2020 ONSEC 6.

[2] *Ibid* at para. 47.
