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OSC Articulates Expectations of Special Committees in Conflict of Interest Transactions: The HBC Privatization

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On December 19, 2019, the Ontario Securities Commission issued an order requiring Hudson's Bay Company (HBC) to postpone its shareholders' meeting called to consider a privatization proposal by a group of majority shareholders led by HBC executive chairman Richard Baker and to amend its information circular to disclose additional information. The privatization was structured in such a way that HBC would purchase for cancellation all of its outstanding common shares, other than those held by its majority shareholders, with the result that after the transaction HBC would be owned by the majority shareholders.

The order provides guidance on the Commission's expectations of special committees and standards of disclosure in material conflict of interest transactions. The terms of the order underscore the guidance in CSA Staff Notice 61-302¹ and make clear that the Commission will rigorously scrutinize conflict of interest transactions, with a focus on the special committee's mandate, timing of formation and process, adequacy of disclosure with respect to the rationale for decisions made by the special committee, and the importance of independent counsel in the special committee process. The full reasons for the decision will be provided by the Commission in due course.

Background

In February 2019, representatives of HBC, including Mr. Baker and other members of management, commenced discussions with representatives of HBC's European joint venture partner, SIGNA, about a potential sale to SIGNA of HBC's remaining interest in the joint venture (SIGNA Transactions). Shortly thereafter, discussions ensued between Mr. Baker and HBC shareholders representing, together with Mr. Baker, 57.7% of the then-outstanding common shares of HBC (collectively, Majority Shareholders) regarding whether proceeds from the potential SIGNA Transactions could provide financing for a privatization transaction involving HBC.

In late March 2019, Mr. Baker and other members of management informed HBC's lead independent director, David Leith, about Mr. Baker's desire to evaluate a potential privatization transaction together with the other Majority Shareholders – the privatization transaction being contingent on proceeding with the SIGNA Transactions. Mr. Leith consented to Mr. Baker's exploring such a transaction and sharing certain financial information with the other Majority Shareholders on a confidential basis. Mr. Leith also consented to Mr. Baker's use of HBC's historical transaction counsel in connection with the initial evaluation of a privatization transaction. Shortly thereafter, the board of directors of HBC (Board) established a special committee of independent directors, chaired by Mr. Leith, to supervise the review of HBC's options with respect to the joint venture with SIGNA and certain other businesses of HBC. The special committee's mandate did not expressly contemplate the review of any privatization proposal. The special committee conducted further negotiations with Mr. Baker and, in April 2019, retained counsel in connection with the possibility of receiving a privatization proposal.

The mandate of the special committee was not enlarged to consider a privatization proposal until June 9, 2019, three days after the special committee received the Majority Shareholders' proposal letter and proposed press release. Following consideration by the special committee, the Board also waived a standstill provision binding one of the potential Majority Shareholders in order to allow it to participate in the privatization proposal and approved the entry by HBC into the SIGNA Transactions. On June 10, 2019, HBC announced the SIGNA Transactions and the Majority Shareholders announced their privatization proposal for HBC. Beginning in the summer of 2019, The Catalyst Capital Group Inc. (Catalyst) pursued a competing bid to acquire shares of HBC.

In October 2019, HBC announced that it had entered into an arrangement agreement with the Majority Shareholders to privatize HBC (the Privatization Transaction). On November 25, 2019, HBC filed its management information circular for the special meeting of shareholders to vote on the Privatization Transaction. Following the special committee's rejection of Catalyst's offer on the basis that it was not capable of being completed without the support of the Majority Shareholders, Catalyst commenced its application to the Commission to block the Privatization Transaction.

On December 6, 2019, the special committee issued a press release amending the circular to include certain additional information relating to the background to the SIGNA Transactions and the development of the initial privatization proposal. The press release disclosed, among other information, (i) when Mr. Baker and the Majority Shareholders first considered a privatization proposal; (ii) when Mr. Leith was made aware of the potential for a privatization proposal and his response to Mr. Baker's requests in relation to such a potential transaction; (iii) the scope of the special committee's mandate in its oversight of the SIGNA Transactions; (iv) the explicit link between the proceeds from the SIGNA Transactions and any privatization proposal; (v) the extent to which the special committee considered the timing of the announcement of a privatization proposal together with the announcement of the SIGNA Transactions; (vi) the special committee's waiver of the standstill provision with one of the Majority Shareholders; and (vii) the evolution of the special committee process and mandate leading up to the initial privatization proposal.

The Hearing

Catalyst's Application

On December 6, 2019, Catalyst brought an amended application for a hearing before the Commission to cease-trade the Privatization Transaction under the Commission's public interest powers or, in the alternative, to require HBC to amend its circular and delay the shareholders' meeting to vote on the Privatization Transaction. Catalyst argued that the initial privatization proposal was negotiated among the Majority Shareholders through a non-arm's-length process and in reliance on material non-public information concerning the terms of the SIGNA Transactions. In Catalyst's view, the Majority Shareholders acted in a coercive manner and formed an "artificial control block" that nullified the authority of the special committee to consider alternative transactions available to HBC. Catalyst also pointed to the Board's waiver of a standstill provision in furtherance of the Privatization Transaction as evidence of a flawed process. In addition, Catalyst argued that the circular filed by HBC misrepresented the process leading to the arrangement agreement and failed to include key material information. Catalyst also challenged HBC's reliance on certain valuations and appraisals on the basis of alleged limitations on the scope of the review.

Staff's Position

At the hearing, OSC staff rejected Catalyst's contention that the procedural and disclosure deficiencies in respect of the Privatization Transaction warranted cease-trading the transaction.

However, in Staff's view, the process followed prior to the adoption of the revised mandate of the special committee on June 9, 2019 did not allow for the appropriate management of the conflict of interest between the Majority Shareholders and the public minority shareholders. In particular, the mandate of the special committee that was formed on March 27, 2019 did not contemplate a review of any privatization proposal, and the special committee did not retain its own legal and financial advisers at that time.

Staff noted that the circular omitted material information, including the additional information disclosed in the December 6 press release, information regarding incentive compensation payouts and other benefits to be obtained by certain Majority Shareholders, and information regarding the involvement of Mr. Baker and other conflicted members of management in the negotiation of the SIGNA Transactions. Staff took the position that while supplemental disclosure in the form of a press release could be curative in certain circumstances, the confusion created by HBC's varying disclosure could be remedied only by the issuance of an amended and restated circular. Staff also noted that the impact of any limitations on the appraisal conclusions should be made in the amended circular.

The Order

The Commission issued an interim order on December 13, 2019, delaying the shareholders' meeting to vote on the Privatization Transaction until HBC delivered an amended information circular to the shareholders. On December 19, 2019, the Commission issued a final order requiring HBC to include the following information in the amended circular together with "a meaningful discussion and analysis of the implications of that information for purposes of the Transaction and the shareholder vote":

- the special committee chair's decision to consent to the disclosure of certain financial information to the Majority Shareholders and to Mr. Baker's use of HBC's historical transaction counsel in connection with the contemplated privatization proposal, in each case without the benefit of a special committee authorized to consider the privatization proposal and without the advice of counsel;
- the Board's reasons for deciding that a special committee was not required to address the conflicts of interest arising from the contemplated privatization proposal until June 9, 2019;
- the special committee's considerations with respect to the waiver of the standstill provision, the definition of "Superior Proposal" in the arrangement agreement and the impact of the foregoing on the viability of alternative transactions;
- the special committee's discussions regarding the timing of the press releases announcing the SIGNA Transactions and the privatization proposal, and the implications on the market's response and the magnitude of the premium reflected in the privatization proposal;
- reconciliation of the disclosures made subsequent to the filing of the management information circular; and
- a description of any limitations on the scope of HBC's appraisals and their impact on the valuation conclusions.

In addition, the order required HBC to submit its amended circular to Staff for review at least five days prior to its distribution to shareholders and to provide Staff with minutes of meetings and all relevant corporate records for review.

Implications of the Order

The order confirms the high standard of conduct and disclosure for material conflict of interest transactions set out in CSA Staff Notice 61-302. Commissions will assess the steps taken by the board and special committee to protect minority shareholders, including the following:

- the early formation and engagement of a special committee with a broad mandate to consider the transaction and available alternatives;
- the retention of independent legal counsel and advisers by the special committee;
- the supervision of negotiations by the special committee; and
- the complete and timely disclosure of information to shareholders in the management information circular, including substantially the same information provided to the special committee during its review and approval process and information explaining key decisions made by the special committee on issues where a conflict of interest might arise.

Boards of directors of public companies should guard against the possibility of regulatory intervention by proactively establishing rigorous processes to manage conflicts of interest and ensuring that disclosure is sufficient to enable an informed shareholder vote. We will provide additional commentary when the full reasons for the decision are released.

¹ Multilateral CSA Staff Notice 61-302, Staff Review and Commentary on Multilateral Instrument 61-101, Protection of Minority Security Holders in Special Transactions (MI 61-101).

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