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DELAWARE COURT OF CHANCERY INVALIDATES CONSENT RIGHTS AND CERTAIN DESIGNATION-RELATED RIGHTS IN A STOCKHOLDER AGREEMENT

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On February 23, 2024, Vice Chancellor J. Travis Laster of the Delaware Court of Chancery issued a long-awaited opinion[1] ruling on the validity of pre-approval requirements and board- and committee-related designation rights included in the stockholder agreement between a public company and its founder that was entered into before the company went public.

The decision calls into question the enforceability of certain stockholder consent and designation-related rights that have long been considered market-standard and are found in many stockholder agreements for both public and private companies. This article summarizes the provisions that were challenged in the case and the Court's decision. The decision left many questions unanswered.

Challenged Provisions

The challenged provisions in the case fall into two primary categories: (i) pre-approval requirements (commonly referred to as "consent" or "veto" rights[2]) and (ii) board and committee composition provisions (so-called "designation" provisions). The plaintiff challenged the facial validity of these provisions in the company's stockholder agreement on the basis that they violate Section 141(a) of the Delaware General Corporation Law ("DGCL"), which provides that "the business and affairs of every corporation organized . . . [in Delaware] shall be managed by or under the direction of a board of directors, except as may be otherwise provided . . . [under the DGCL] or in its certificate of incorporation." The plaintiff also argued that the committee composition-related rights further violate Section 141(c) of the DGCL, which provides that company boards are tasked with forming committees.[3] Specifically, the plaintiff challenged[4] the following provisions (the "Challenged Provi-

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enforceable, would. For example, the benefit to be forfeited may turn out to be too small to provide any real incentive not to compete (and its value likely will not be knowable until such time as the employee leaves). Even if the benefit to be forfeited is sufficient to provide a real incentive not to compete, the subsequent employer may choose to reimburse the employee for the forfeiture; and/or offer high enough remuneration that the forfeiture becomes less consequential. Also, the subsequent employment may be so attractive for other, possibly non-financial, reasons that the forfeiture is not compelling. On the other hand, however, in situations where the financial forfeiture is very significant, a forfeiture-for-competition provision may provide the most effective disincentive to competing.

ENDNOTES:

[1]*Cantor Fitzgerald, L.P. v. Ainslie, C.A.* No. 9436 (Del. Jan. 29, 2024).

"JOINT ACTORS" IN SHAREHOLDER ACTIVISM IN CANADA: DID CANADA JUST GET MORE "ACTIVIST FRIENDLY?"

By Brad Freelan, Brad Moore and Paul Blyschak

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United States-based shareholder activists have been increasingly active in the Canadian market over recent years. Indeed, Canada is also often described—sometimes accurately and sometimes inaccurately—as a more "activist friendly" jurisdiction than the United States. This being the case, U.S. investors considering a proxy contest involving a Canadian-based issuer will be interested to learn of a recent, and generally "activist friendly" decision made under Canadian securities law.

Specifically, it (1) sets a "relatively high" standard for finding shareholders to qualify as "joint actors" under securities law, and (2) underscores the importance of the alleged "joint actors" having "actively worked together" in pursuit of a "joint specific purpose." Perhaps most notably, in the circumstances at hand, this meant a shareholder was not "acting jointly" with two dissident shareholders even though the first shareholder (1) nominated a director on the dissidents' alternative slate, and (2) funded the majority of the dissidents' proxy solicitation campaign.

"Joint Actor" Status Under Canadian Securities Law

The public issuer was a mining company (the "Issuer") and the question before the British Columbia Securities Commission (the "Commission") was whether three of its shareholders—two of whom were dissidents orchestrating a proxy contest promoting their alternate slate of directors—together qualified as "joint actors" under securities law.[1]

The issue matters because, amongst other things, becoming "joint actors" can lead to public disclosure obligations under Canada's early warning requirements ("EWR"). In particular, once two or more persons collectively holding 10% or more of an issuer's securities qualify as "joint actors," any subsequent acquisition of the issuer's securities by any of them triggers EWR disclosure duties.

In Canada, persons will be presumed to be joint actors where, pursuant to an agreement, commitment or understanding between them, they intend to exercise jointly or in concert voting rights attached to securities of an issuer.[2] Canadian caselaw has elaborated that acting jointly or in concert requires that the persons have made "a concerted effort to bring about a specified objective" and that mere "alignment of interests" does not suffice.[3]

The AGM and the Dissident Slate of Directors

Dissident 1 was a 0.4% shareholder, Dissident 2 was a 3.9% shareholder, and Dissident 3 was a 7.9% shareholder. The "key figure" for the Commission was Dissident 3 as, without his 7.9% shareholding, the aggregate 10% or greater shareholding necessary for "joint actor" status could not be reached.

The Issuer's annual general meeting ("AGM") was scheduled for June 23, 2023. On May 19, 2023, Dissident 1 delivered official notice (and issued a related press release) that he planned on nominating an alternate slate of directors at the AGM. The notice expressly provided that he was not acting jointly with any other shareholders.

Dissident 1's alternate slate caused the Issuer to postpone its AGM, first until September 6, 2023 and ultimately until September 19, 2023. The Issuer also responded by asserting Dissident 1 was acting jointly with Dissidents 2 and 3 in connection with his alternate slate and was obligated to disclose that fact under securities regulations. When Dissident 1 did not do so, the Issuer instituted proceedings before the Commission seeking to, *inter alia*, compel such disclosure and prohibit Dissidents 1, 2 and 3 from voting their shares at the AGM.

Evidence Supporting "Joint Actor" Status

The evidence relied on by the Issuer focused on the relationship among the Dissidents, both surrounding the dissident campaign and beforehand. Key facts supporting the Issuer's allegations were:

- Dissidents 1 and 2 had known each other for several years prior to the events at issue.
- Dissident 3's personal company had loaned Dissident 2 $500,000 for him to put towards participating in a January 2023 private placement of securities by the Issuer.
- In April 2023, Dissidents 1 and 2 began discussing the possibility of effecting change to the Issuer's board.
- In subsequent text messages to third parties, Dissident 1 implied that decisions regarding a potential proxy battle for the company's board were being made jointly by himself and Dissident 2.
- Dissident 1 described the dissident slate to third parties as being the consensus of multiple shareholders, including Dissident 2.
- When Dissident 2 approached Dissident 3 regarding the possibility of replacing some of the Issuer's directors, Dissident 3 expressed interest in having a representative on the board.
- Dissident 3's nominee, as later communicated to Dissident 2, was included in the dissident slate ultimately compiled by Dissident 1.
- Dissident 3 agreed to fund the majority of the costs of the proxy solicitation campaign conducted by Dissident 1.
- During the dissident campaign, Dissidents 2 and 3 met with another Issuer shareholder during which meeting, among other things, the Issuer had been discussed.

The crux of the Issuer's argument was therefore that it "defied belief" to suggest Dissident 3 had no intention to vote his shares in favour of the dissident slate when (1) the slate included his nominee, and (2) he funded the majority of the costs of the proxy battle for that slate. Also underlying this assertion was (1) the historic relationship between Dissidents 2 and 3, and (2) the coordination amongst Dissidents 1 and 2 regarding the dissident campaign.

Evidence Countering "Joint Actor" Status

The evidence presented by the Dissidents of most significance to the Commission was that relating to

Dissident 3 and his individual motivations in the circumstances. This included:

- Apart from choosing his representative on the dissident slate, Dissident 3 was not otherwise involved in compiling the slate and had never met any of the other nominee directors.
- Notwithstanding his association with the dissident campaign, Dissident 3 had also been negotiating a voting support agreement with the Issuer whereby he would gain a nominee on the Issuer's board in exchange for supporting management's slate of directors.
- The Issuer terminated these negotiations only upon learning that Dissident 3 was contributing to the dissident campaign.
- Dissident 3 had expressed concern to the Issuer that despite his support of management, the dissident slate might win, leaving him with a substantial share position without representation, and he sought to mitigate that risk.
- Despite nearing agreement on the voting support agreement with the Issuer, Dissident 3 did not inform Dissidents 1 and 2 of his negotiations with management.
- In his discussions with the Issuer, Dissident 3 stated he was not part of any group, but was simply protecting his own best interests.

The Commission noted that when opportunities to be represented on the Issuer's board arose—whether through the dissident slate or the Issuer's negotiations to secure his support—Dissident 3 pursued those opportunities.

The Commission's Analysis: Insufficient "Active Work" Towards a "Joint Specific Purpose"

It was common ground that no formal agreement existed among the Dissidents to jointly vote for Dissident 1's slate. As such, the question was whether the Commission was prepared to infer from circumstantial evidence that an informal understanding existed among the Dissidents sufficient to constitute a "plan of action" and "commitment to pursue it."

The Commission held the burden was on the Issuer to adduce evidence that established such an understanding among the Dissidents on a balance of probabilities (i.e., whereby the understanding and "specified objective" appeared more likely than not).

The Commission made clear it would be "cautious in drawing inferences from circumstantial evidence." Specifically, it noted that "before drawing an inference that something must be so," it would "balance the strength of the circumstantial evidence against the reasonableness of other explanations that might explain the same circumstance."

This approach proved crucial. On the one hand, the Commission acknowledged circumstantial evidence suggesting joint action to a degree that "justified a very careful and skeptical review of the Dissidents' explanations." On the other hand, however, it ultimately held the Dissidents had provided "credible and plausible alternative explanations" in response.

Key here was the Commission's finding that Dissident 1 was a "sophisticated" investor who was "at all times" acting "independently in his own interests without regard for the interests of others." The Commission found that, rather than having shared a "common specific purpose" with Dissidents 1 and 2 regarding the dissident slate, Dissident 1 appeared "throughout to have been solely motivated to place his own representative on the board by whatever means presented themselves."

It was plain that Dissident 3 had shown clear interest in Dissident 1's slate and had nominated a representative on that slate. However, Dissident 1 had also negotiated with the Issuer for "a totally different result," namely to support the company's slate in exchange for a representative on that board. This

"undermined the argument" that Dissident 1 was "engaged in a common enterprise with Dissidents 1 and 2." Perhaps most importantly, the Commission required further evidence that Dissident 3 was "himself engaged" in the "active and coordinated effort" to achieve the installation of Dissident 1's slate at the AGM.

As for Dissident 3's financing of Dissident 1's proxy solicitation campaign, the Commission described this as "not the route that would be chosen by every disaffected shareholder." However, the Commission also found credible Dissident 3's explanation that he was willing to do so to "keep his options open." Importantly, the Commission held the amount of money spent by Dissident 3 supporting the proxy campaign was "of no particular consequence to him." Nor did the Commission view Dissident 3's "financial contribution" as evidence "he was involved, much less actively involved, in the planning or preparation" of Dissident 1's proxy solicitation campaign.

Finally, and significantly, the Commission ruled "the bar for a finding that parties are acting jointly or in concert is appropriately set relatively high . . ." Its rationale was policy-based, the Commission explaining as follows:

> Disclosure of shareholder blocks is important, but so is the free flow of information and opinion among shareholders of a public company. We conclude that it is better to insist on sufficiently clear, convincing and cogent evidence that parties are acting jointly or in concert and take the risk that by doing so, some groups will fly under the radar, than to allow reliance on speculation to create a climate that stifles discussion among shareholders.

The end result was that, while Dissident 3 may have been "aligned in interest" with Dissidents 1 and 2, this alone was insufficient. What was required was evidence establishing the three had "actively worked together to achieve a joint specific purpose," a standard the Issuer had failed to meet.

Key Takeaways for U.S. Investors and Potential Activists

Proxy contests for control of an issuer's board necessarily involve soliciting shareholder support for the dissident's slate of directors and often involve discussions among shareholders who have similar or overlapping objectives in mind. The Commission's decision provides helpful—and generally "activist friendly"—guidance regarding when such discussions could amount to two or more shareholders being "joint actors" under Canadian securities law.

Most significantly, it (1) sets a "relatively high" standard for finding "joint actor" status, and (2) underscores the importance of the alleged "joint actors" having "actively worked together" in pursuit of a "joint specific purpose." The rationale for the foregoing is also policy-based and prioritizes the "free flow of information and opinion among shareholders of a public company" over a lower standard that could "create a climate that stifles discussion among shareholders."

ENDNOTES:

[1]See *NorthWest Copper Corp. (Re)*, 2023 BCSECCOM 602 (CanLII).

[2]See *National Instrument 62-104 Take-Over Bids and Issuer Bids* at s.1.9(1)(b)(i), the text of which reads: "1.9 (1) In this Instrument, it is a question of fact as to whether a person is acting jointly or in concert with an offeror or an acquiror and, without limiting the generality of the foregoing . . . (b) the following are presumed to be acting jointly or in concert with an offeror or an acquiror: (i) a person that, as a result of any agreement, commitment or understanding with the offeror, the acquiror or with any other person acting jointly or in concert with the offeror or the acquiror, intends to exercise jointly or in concert with the offeror, the acquiror or with any person acting jointly or in concert with the offeror or the acquiror any voting rights attaching to any securities of the offeree issuer;"

[3]See *Genesis Land Development Corp. v Smoothwater Capital Corporation*, 2013 ABQB 509 (Can-

LII), *Kingsway Financial Services Inc. v. Kobex Capital Corp.*, 2016 BCSC 460 (CanLII), and *Re DIRTT Environmental Solutions Ltd.*, 2023 ABASC 32 (CanLII).

NOT A CRYSTAL BALL: THE CLAYTON ACT, MERGER PROHIBITION, AND STRUCTURAL PRESUMPTION

By Michael Kades

Michael Kades is Deputy Assistant Attorney General in the Antitrust Division of the Department of Justice. The following is edited from remarks that he gave at GCR Live: Law Leaders Global 2024 in Miami on February 1, 2024.

I want to focus on the text of Section 7 of the Clayton Act and the economic consensus supporting the structural presumption. Why these two topics? Because they are two of the most contentious issues in merger litigation: the government's burden and the value of the structural presumption.

First, the Clayton Act prohibits mergers that may substantially lessen competition. That text prohibits mergers as long as competitive harm is reasonably probable—even if harm is unlikely in the sense of less than 50%. That text requires skepticism of rebuttal evidence. And, that text reflects an error cost judgment in favor of enforcement.

Second, modern economic theory and empirical work support continued reliance on the structural presumption—the structural presumption is more than good law, its good policy.

Let's start with the statute.[1] It says "may"—not that the effect "is to substantially lessen competition,"[2] not the effect "is possibly to substantially lessen competition," and not that the effect "is certain to substantially lessen competition."[3] Congress considered all these alternatives. But the word they chose was "may." Specifically, Congress changed the language from "where the effect is" to "where the effect may be," which Senator Chilton explained meant "where it is possible for the effect to be."[4]

As the Supreme Court has repeatedly stated, this standard requires only a "reasonable probability" of substantially lessening competition. Reasonable probability does not mean any possibility. For example, the chance that the United States would defeat the USSR in Hockey at the 1980 Olympics was not a reasonable probability—there is reason it is called the Miracle on Ice.

In *California v. American Stores*, the Supreme Court's last discussion of the standard, they not only quoted the "may be" in the Clayton Act, they italicized it, and they added that these words create "a relatively expansive definition of antitrust liability."[5]

The Court has also described the standard as requiring plaintiffs to prove the acquisition creates a threat of competitive harm. As described in *General Dynamics*, successful rebuttal evidence "mandate[s] a conclusion that no substantial lessening of competition [is] threatened by the acquisition."[6] The D.C. Circuit in *Baker Hughes* relied on a similar formulation.[7] Rebuttal evidence must ameliorate the threat of substantially lessening competition. The Court is talking about the risk of an anticompetitive effect.

The case law confirms the plain meaning of the statute: Section 7 does not require that the harm be more likely than not. As long as the harm is reasonably probable,[8] Section 7 bars some mergers that are more likely than not to have no—or even a positive—effect on competition.

And as Doctor Steven Salop has pointed out, when combined with the burden of proof, it means the government must prove by a preponderance of the evidence that the acquisition "may substantially lessen competition."[9]

This insight has at least two important implications