OSC decision a reminder to engage a special committee early

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The Ontario Securities Commission (OSC) recently released the reasons for its December 2019 decision in *Re The Catalyst Capital Group Inc.*

In the decision, the OSC did not cease trade a proposed take-private transaction of Hudson's Bay Company (HBC) by its executive chairman Richard Baker and certain other shareholders (together with Baker, the Shareholder Group). The OSC did, however, require HBC to amend its proxy circular relating to the take-private that resulted in a delay of HBC's shareholder meeting.

In its reasons, the OSC discussed procedural aspects in forming a special committee in relation to, and disclosure for, material conflict of interest transactions (including those governed by Multilateral Instrument 61-101 – *Protection of Minority Security Holders in Special Transactions*). The OSC was also critical of certain actions taken by the lead director prior to forming a special committee. The OSC decision highlights the importance of establishing a special committee early in the process of a potentially material conflict of interest transaction.

Background

In February 2019, HBC representatives, including Baker, began discussing with HBC's European joint venture partner representatives potentially selling HBC's 50 per cent interest in its European joint ventures (the SIGNA Transaction). Shortly after these discussions, Baker and other members of HBC management discussed the potential that the proceeds from the SIGNA Transaction could provide financing for the Take-Private.

In late March 2019, Baker advised David Leith, HBC's lead director, that the Shareholder Group was evaluating the take-private, which would be conditional on completing the SIGNA Transaction. Leith permitted sharing limited financial information with the Shareholder Group, and its use of HBC's historical legal transaction counsel.

Two days later, HBC's directors established a special committee of independent directors (the Special Committee), with a mandate to review HBC's European joint ventures. At the time, the mandate did not extend to the take-private. Over the next few

months, the Special Committee mandate expanded to include early steps to ensure that if and when a proposal was received in relation to a Take-Private, legal counsel and financial advisors would be considered and ready. On April 27, 2019, Baker again expressed the possibility of the take-private.

On June 9, 2019, the Special Committee's mandate further expanded to include consideration of the take-private. On June 10, 2019, a definitive SIGNA Transaction agreement was entered into. Shortly after, the Shareholder Group proposed the take-private at a price of $9.45 per common share.

Over the next four months, the Special Committee and the Shareholder Group negotiated the terms of the take-private and ultimately entered into an arrangement agreement that provided for a price of $10.30 per common share.

On December 2, 2019, Catalyst Capital Group Inc. (Catalyst), a large minority HBC shareholder, filed a notice of application for a hearing with the OSC in order to permanently prohibit the take-private.

In its December 13, 2019 decision, the OSC refused to cease trade the take-private, but did require that HBC amend its proxy circular to include the lead director's decision-making process and a review by OSC staff before being mailed to shareholders.

On January 3, 2020, the Special Committee, the Shareholder Group and Catalyst entered into a support agreement that provided for, among other things, an increased price of $11 per share for the take-private. At HBC's shareholder meeting on February 27, 2020, shareholders voted in favour of the Take-Private.

OSC review of special committees

In its decisions, the OSC examined the law relating to special committees. Two important aspects of the OSC's consideration of special committees includes: (i) if a board establishes a special committee when it is not strictly required to do, the disclosure related to its process will be subject to the same scrutiny as if a special committee was legally required, and (ii) in the context of potentially material conflict of interest transactions, special committees should be created early in the process before any important decisions are made.

In the context of the take-private, the OSC found that the lead director should not have decided on his own to share confidential information with members of the Shareholder Group or to permit the group to use HBC's legal counsel. Instead, the OSC said, a "properly mandated and advised special committee" should have been used to make these business judgements before important decisions were made and prior to possible ramifications linked to these decisions.

The OSC commented that the Special Committee should have been created early on to consider the SIGNA Transaction, the take-private and the interconnected aspects of the two transactions.

While the OSC concluded that the issues relating to the Special Committee did not warrant a cease trade order in relation to the take-private, it did require HBC to amend its circular and mail a blackline of the amended circular to shareholders.

Takeaway

Boards and their advisors should be mindful of the OSC's statements regarding creating special committees early on in any process involving a potentially material conflict of interest transaction. This is particularly relevant in the case of take-private transactions by management or large shareholders, where there is likely to be conflicts of interest.

*The author gratefully acknowledges the assistance of articling student **Tiffany Dodds** in writing this article.*

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