CCGG INVESTOR PERSPECTIVE 2024 LOOKBACK GILDAN ACTIVEWEAR: A CORPORATE GOVERNANCE CASE STUDY



Introduction

2024 saw one of Canada's messiest board room battles in recent memory at Gildan Activewear. The facts, which are well known to Canadian institutional investors, include the sudden departure of the founder CEO at the behest of the board, a controversial voting support agreement with an activist investor, surprised long-term shareholders, a public airing of grievances between the board and the former CEO, an executive mutiny and an ultimately successful, but expensive, proxy battle to reinstate the former CEO and replace the board.

The leadership battle was resolved with the reinstatement of the former CEO and the installation of an entirely new, dissident supported board, just prior to the company's annual general meeting in May 2024, after it became apparent that the incumbent board did not have the needed votes¹. In our view, the end result demonstrates that shareholder democracy and effective voting rights remain the most effective corporate governance mechanisms to hold boards accountable for their decisions.

The importance of CEO succession planning

When a CEO is a long-tenured founder of the business, the process of succession planning can be both complex and delicate. In Gildan, proxy advisors ISS and Glass Lewis both recommended that shareholders vote to support the dissident slate. In doing so, both advisory firms highlighted concerns about the succession planning process and rationale behind the board's decision to replace CEO, Glenn Chamandy, given the company's strong track record of performance under his leadership and the depth of shareholder support he commanded².

¹ Many articles have been written on this topic, for a good summary see: <u>Andew Willis, Gildan Board resigns, clearing the way for Glenn Chamandy to retake control of clothing company, Globe and Mail, May 23, 2024</u>. This perspective is based on a CCGG staff review of publicly available documents, articles and commentary. As a coalition, CCGG strives to build and reflect a consensus but, while supportive of CCGG's mission and mandate, CCGG's Members are not individually bound by CCGG's positions or publications.

² While the recommendations are not publicly available both the Glass Lewis and ISS rationales are extensively quoted in press releases issued by the dissident shareholder Browning West. See: <u>ISS</u> Recommends Gildan Activewear Shareholders Vote the GOLD Proxy Card "FOR" ALL EIGHT of Browning West's Director Candidates, Including Former CEO Glenn Chamandy, May 17, 2024, businesswire; and

Highlighting the importance that shareholders place on the board's responsibility to oversee CEO succession planning, both proxy advisors also observed that they considered the dissident board slate to have the appropriate skills and experience needed to appropriately manage a future succession planning process³.

Key takeaways for boards include:

- The CEO succession planning process, including board oversight of appropriate policies and procedures, must be transparent, vigorous and credible;
- Boards should communicate with shareholders, especially their long-term institutional investor shareholders, if succession plans do not go as planned or sudden changes are required⁴; and
- Founder CEOs with a long track record of strong performance may be given a higher degree
 of deference by institutional shareholders, raising the threshold on the board to have and to
 effectively communicate a compelling rationale to justify a decision to remove the CEO.

The importance of shareholder democracy

At the end of the day, Gildan's shareholders were able to leverage the mechanisms in corporate law that facilitate shareholder democracy, including attempting to requisition a shareholder meeting and the ability to nominate directors and trigger a proxy contest. These powerful tools are foundational elements of effective corporate governance.

Voting Support Agreements should be shields not swords

One controversial tool, that also relies on the power of shareholder votes, used by the Gildan board to shore up support for its decision to remove the CEO and fend off a pending activist campaign from investor Browning West, was the defensive use of a voting support agreement. A substantial portion of Gildan's shareholders objected to the agreement Gildan entered into with its second largest investor, Coliseum Capital, in which Coliseum committed to vote its shares to

Glass Lewis Joins ISS in Recommending Gildan Activewear Shareholders Vote the GOLD Proxy Card "FOR" ALL EIGHT of Browning West's Director Candidates, Including Former CEO Glenn Chamandy, May 20, 2024, businesswire.

³ Although it should be noted that not all institutional investors supported Chamandy, see <u>News Release</u>, <u>Gildan Announces a C\$200 Million Private Placement Financing with CDPQ</u>, May 8, 2024.

⁴ See guidance to boards in <u>CCGG, Building High Performance Boards, 2025</u> at Guiding Principle 4.3 Assess the Chief Executive Officer and Plan for Succession

support the board's nominees for two years in exchange for a board seat and a commitment to acquire further shares⁵.

The purpose of this voting support agreement was for the incumbent board to lock up important votes for two years.

Voting or support agreements are not illegal or prohibited under corporate law, and can be viewed as a vehicle to proactively settle with an activist in a way that can save a company both time, money and the potential reputational risk of a pro-longed or nasty proxy battle⁶. Additionally, it can be argued that one of the strongest exercises of a shareholder's right to use its votes is to confirm its support for a board or transaction through such an agreement. There is a question, however, as to whether it is appropriate for a shareholder to lock up its future votes for a period of time regardless of how the relevant factual context could change during that time.

The defensive use of such an agreement, however, can be problematic from a corporate governance perspective for a variety of reasons including:

- locking up a proportion of votes with the effect of entrenching the incumbent board, potentially undermining the effectiveness of annual director elections;
- weakening the credibility and integrity of annual director evaluations, board succession planning and related corporate governance best practices; and
- aligning the board and the assets of the corporation with the interests of one of its shareholders to the potential detriment of others⁷.

⁵ See <u>Standstill Agreement dated December 17, 2023 between Coliseum Capital Management, LLC and Gildan Activewear Inc.</u> at para 1 (a)-(b) and 2(a) and (b); Coliseum also agreed to support the board if it determined "to adopt an ISS compliant shareholder rights plan" within a specified period at para 2(b).

⁶ "Negotiating a compromise solution (for example, the board and management execute a plan of action proposed by the shareholder or accommodate the shareholder proposal)" is identified as an appropriate step to take when faced with shareholder activism in Christian Brands and Meghan Jones, Shareholder Activism and Shareholders' Rights in Private and Public Companies in Canada Overview", Stikeman Elliott LLP, Feb 01, 2023. For a comparison of the risks and benefits of settlement verses a proxy contest see: Ontario Securities Commission, <u>Capital Markets Adjudicators' Policy Forum, Emerging Issues in Shareholder Activism and Related Control Contests</u>, November 20, 2024 at slide 34.

⁷ Other *potential* securities laws issues have been noted with respect to the use of voting agreements including that they "may give rise to concerns over (i) "tipping"; (ii) illegal "proxy solicitations"; (iii) non-compliance with securities laws around "restricted securities" relative to other classes of securities; and/or public interest concerns over defensive tactics". Ontario Securities Commission, <u>Capital Markets</u> <u>Adjudicators' Policy Forum, Emerging Issues in Shareholder Activism and Related Control Contests</u>, November 20, 2024 at slide 33.

The TSX has issued a staff notice in respect of how it will treat voting support agreements which reflects the importance of shareholder democracy in such arrangements. The TSX defines "voting agreements" as agreements "that require a security holder to vote, or cause to be voted, any voting securities that it holds, or over which it exercises control or direction, directly or indirectly, as directed by management or in favour of one or more management proposals" 8.

While the scope of its authority and review is generally limited to reviewable circumstances that materially affect control, the staff notice indicates that a voting agreement will generally be acceptable to the TSX if (1) the listed issuer has obtained disinterested security holder approval for the Voting Agreement; or (2) the Voting Agreement allows a covenanting security holder to abstain, or not participate, in a security holder vote. Such so called 'negative' voting agreements are considered not to materially affect control and therefore not require broader shareholder approval⁹. Notably, the TSX's guidance is premised on the importance of leveraging shareholder democracy to require a majority of shareholders approve agreements in which their interests could be materially altered through one or a handful of other shareholders agreeing to vote in support of the board and management.

In circumstances where there has been no such approval or the voting agreement requires votes 'for' management, the TSX identifies other factors it would consider with a view to determining if the agreement would have "a material impact on the control of the issuer" and thus be subject to review. These factors would include the term of the agreement; the proportion of outstanding voting securities caught by the agreement and the potential for the agreement to influence the outcome of a vote; the context in which the agreement is established and the consequences for the shareholder counterparty on breach¹⁰. All of which, taken together, mean that the corporate governance implications of the use of a voting agreement in any particular situation are highly contextual and fact specific.

⁸ TSX Staff Notice 2023-0001, Voting Agreements, Staff Notice to Applicants, Listed Issuers, Securities Lawyers and Participating Organizations, February 27, 2023.

Ontario Securities Commission, <u>Capital Markets Adjudicators' Policy Forum, Emerging Issues in Shareholder Activism and Related Control Contests</u>, November 20, 2024 at slide 33.
¹⁰ Ibid.

Key takeaways for boards include:

• In the Gildan context, the voting agreement was used defensively to support a board slate of which a significant number of other shareholders were publicly critical, indicating the agreement was potentially being used as a board entrenchment device that would enable the board to follow through with its decision to replace the CEO; a decision the company's largest shareholders objected to. At least two shareholders were publicly critical of the defensive use of the voting agreement – characterizing it as a "serious governance concern" 11.

The importance of stakeholder engagement and corporate culture

One of the lesser reported outcomes of the CEO transition was a reported letter to shareholders from some of Gildan's executives, urging the reinstatement of the former CEO¹². This is a somewhat overlooked but important development in the dispute because, if true, it could point to a lack of understanding by the board as to how the corporation's culture would be impacted by replacement of its founder CEO and the abrupt manner in which it took place.

Similar situations have arisen in other contexts where founder CEOs are abruptly dismissed, with a similar ultimate result being reinstatement and board turnover. For example, when OpenAl's not-for-profit board suddenly dismissed Open Al CEO, Sam Altman, over concerns that he was not being transparent with the board, nearly all of the company's 700 employees signed an open letter demanding his reinstatement and that the board resign¹³.

¹¹ As quoted in the Globe and Mail, Nicolas Van Praet, Gildan investor Jarislowsky says company's appointment of fund manager to board a 'serious governance concern' December 19, 2023: "We find the nomination to the board of a hedge fund manager, who has only held shares since 2022, with the expectation to vote in line with the board for two years, a serious governance concern, and a clear conflict of interest, especially when combined with the fact that this hedge fund owns a stake in one of Gildan's largest customers". The same article also includes the following quote from shareholder Anson Funds, "We are further troubled by the board's decision to strike a backroom deal granting an individual shareholder a board seat in exchange for their support before engaging with other investors". Also see, supra note 2, Glass Lewis as quoted in the Browning West press release: "[...] we are perplexed by the Company's decision to enter into the Coliseum support agreement, particularly given Coliseum's relatively recent accrual of shares in the Company and an unclear vision of the need for the proceeds".

¹² <u>Bloomberg, Rebel Gildan Executives Push for Board Change, Return of Ex-CEO Chamandy, Mint, May 20, 2024.</u>

¹³The Guardian, Dan Milmo and Blake Montgomery, OpenAI staff threaten to quit en masse unless Sam Altman is reinstated: more than 600 employees demand resignation of board after shock firing of chief executive, November 23, 2023. While OpenAI could be its own corporate governance case study given its unique not-for-profit governance structure, there are several parallels than can be drawn to the Gildan example including a sudden decision to dismiss a founder CEO, surprised major shareholders and an adverse reaction from employees as key stakeholders.

Strategic success depends on employee engagement and an appropriate culture to support the strategic goals, and it is imperative that boards have a clear line of sight into how both employee sentiment and the organization's culture will impact and be impacted by leadership transition decisions.

Key takeaways for boards include:

- Understanding employees as key stakeholders in the success of strategy.
- Understanding how an unexpected or rapid shift in leadership or strategy will resonate within a company's culture¹⁴.

The importance of shareholder engagement

The public and vocal response by some of Gildan's long term institutional shareholders to the board's decision to replace the CEO supports the conclusion that significant investors were both surprised by the board's action and that the course of action pursued represented an abrupt departure from prior investor expectations with respect to CEO succession planning. Subsequent attempts by the board to explain its rationale and succession planning process led to an unusually public airing of grievances between the board and the former CEO¹⁵. This exchange did not allay investor concerns, ultimately leading to escalating shareholder activism and defensive tactics from the board, culminating in the proxy battle which led to the election of the dissident board slate and reinstated the CEO.

It is impossible to know from the public record whether the board was unsuccessful in persuading shareholders of its rationale for replacing the CEO or whether it misread the depth of shareholder confidence in Gildan's founder. Under either scenario it is clear that the communication needed to ascertain shareholder sentiment in response to a leadership transition was lacking. In the words of CCGG's CEO, Catherine McCall, "...they should have...been talking to shareholders more. ...If anything, this is going to prompt or encourage more shareholder engagement" ¹⁶.

¹⁴ See guidance to boards in CCGG, Building High Performance Boards, 2025 at Guiding Principle 2 Resilience and specifically 2.1 Oversee Culture; and 2.4 Consider Stakeholder Interests.

¹⁵ Gildan, Gildan Activewear Board of Directors Issues Open Letter to Shareholders, Sets Record Straight on Browning West's Misguided Campaign to Reinstall Former Gildan CEO, January 8, 2024; Statement by Glenn J. Chamandy in Response to the Open Letter to Shareholders Issued by Gildan Activewear's Board of Directors, January 9, 2024, Cision.

¹⁶ Globe and Mail, Nicolas van Praet and Andrew Willis, At Gildan, a board's defeat offers lessons in shareholder management, May 24, 2024.

Key takeaways for boards include:

- Don't catch patient capital, long term investors off guard with sudden changes.
- Provide opportunities for shareholders to have access to independent directors in addition to at the annual meeting in order to discuss issues or questions that may arise ¹⁷.

Conclusion

The Gildan scenario is a clear reminder to all Canadian boards that corporate governance is not a 'tick the box' exercise. It has to be meaningfully executed in board oversight of CEO succession planning, understanding stakeholders and corporate culture, and most importantly in proactive engagement with shareholders.

¹⁷ See guidance to boards in CCGG, Building High Performance Boards, 2025 at Guiding Principle 6.2 Engage with Shareholders; Boards could consider pragmatic approaches to gauging shareholder sentiment such as attending investor days as observers to listen; or reaching out to shareholders informally to talk about what is on the agenda/top of mind.