SHAREHOLDER ACTIVISM AND PROXY CONTESTS: ISSUES AND TRENDS

DAVIES

Contents

In recent years, the level of shareholder activism in Canada has been growing. Although the number of proxy contests in 2016 showed a marked pullback from the record high number in 2015, we had previously noted that the spike in 2015 to 55 contests (exceeding the prior record of 43 contests set in 2009) was exceptional, coinciding with a period of economic downturn in Canada and the continued deterioration in commodity markets. In comparison to that record year, the 35 contests in Canada in 2016 is in line with the long-term upward trend that began a decade ago.[1] It does appear, however, that apart from the spike in 2015, the numbers are beginning to flatten out. It may be that we have now reached what is a new base level of activity, but that we will continue to see periodic spikes driven by macroeconomic factors such as economic downturns and commodity price shocks.

Contests in Canada continue to be focused primarily on the resource sector and on Canada's smaller-market-cap companies. Owing to the nature of the Canadian capital markets, large-cap contests have been infrequent.

Of course, the number of proxy contests alone is not the full measure of the extent of shareholder activism. Past activist successes have motivated boards of public companies to engage with activists privately and to implement changes where a convincing case is made by the activist without the dispute ever entering the public arena. In addition, the influence of activists, coupled with the increased focus of regulators, investors and other market participants on corporate governance and shareholder democracy, has prompted many public companies to be proactive in addressing perceived problems in their performance or governance in an effort to ward off activist overtures even before they emerge.

This article discusses activism trends in Canada and some of the principal issues and challenges faced by both activists and target companies, as well as notable recent developments and contrasts between Canadian[2] rules and the U.S. requirements.

1 The Right to Requisition a Shareholders' Meeting

One of the most powerful rights that shareholders of Canadian corporations enjoy is the right of holders of not less than 5% of the issued voting shares to requisition the directors to call a shareholders' meeting.[3] On receiving a valid requisition proposing proper shareholder business – most commonly, to remove and elect directors – the directors must, within 21 days, call a meeting of shareholders to transact the business stated in the requisition.[4]

CONTENT OF REQUISITION

The requisition right is not quite as powerful as it appears to be due to a series of judicial developments that have made the effective use of the requisition right difficult. Canadian courts have held shareholders to a high standard of technical compliance in submitting requisitions and have demonstrated a propensity to invalidate requisitions on technical grounds. For example, in *Wells v Bioniche Life Sciences Inc.*, a 2013 decision of the Ontario Superior Court of Justice, the Court upheld a board's decision to reject a requisition on the basis that it

1 Proxy contest data from Kingsdale Advisors.

2 For the purposes of this article, our analysis is generally based on the *Canada Business Corporations Act* (CBCA), the federal corporate law under which a majority of Canadian listed companies are incorporated. The corporate statutes of the other major Canadian jurisdictions are substantially similar with respect to proxy solicitation and shareholder rights, with some exceptions that are beyond the scope of this article.

3 Amendments have been proposed to Ontario's *Business Corporations Act* (OBCA) in private member's Bill 101, *Enhancing Shareholder Rights Act, 2017*, which, if adopted, would reduce the share ownership threshold for requisitioning a meeting from 5% to 3% of the voting shares for shareholders of OBCA corporations.

4 CBCA, s. 143.

had not been signed by a registered holder of 5%, even though the shareholder who had submitted the request was known by the board to beneficially own a sufficient number of shares to requisition a meeting.[5]

Canadian courts have also grafted their own additional requirements onto the statutory requirements for requisitions. For example, in *Bioniche* the Court found the shareholder's requisition to be invalid because the dissident proposed the removal of the directors but did not provide any names or biographical information for new directors to be proposed by the dissident. In fact, however, the corporate statutes do not contemplate that a shareholder requisitioning a meeting to remove directors will necessarily propose nominees to fill the vacancies created by the removals. The Court's finding in *Bioniche* constituted a new court-imposed requirement. The Court's requirement for such information to be provided with a requisition could also mean that a dissident must have recruited its nominees well in advance of the date by which notice must be provided under the company's advance notice bylaw (typically 30 days) prior to the meeting.

TIMING OF MEETING

Canadian courts have interpreted the directors' statutory obligation to "call" a meeting within 21 days of the requisition as being satisfied simply by the announcement of a date for the meeting. The board need not actually hold the meeting or even mail a notice of meeting within the 21 days. Rather, the meeting must be held within a reasonable time determined in the good faith business judgment of the directors. What is regarded as a reasonable time will depend on the circumstances – for example, whether the requisitioned meeting pertains to a specific transaction or pending event and whether the requisitioning shareholders would be prejudiced by delay. Delays of up to four to seven months have been accepted by the courts.

Often, boards responding to a requisition will schedule the requisitioned meeting to be held at the same time as the annual general meeting, even if the annual meeting is as much as six months away. This was the case in *Marks v Intrinsyc Software International*,[6] in which the board, citing the disruption and expense of holding a special meeting of shareholders, scheduled the requisitioned meeting to occur at the same time as the annual general meeting, 155 days after the date of the requisition. In considering the dissident's complaint over the delay, the Ontario Superior Court deferred to the business judgment of the board, accepting as reasonable the board's scheduling of the requisitioned meeting to avoid unnecessary costs.

MEETING CALLED BY SHAREHOLDERS

If the directors do not call a meeting within 21 days of receiving the requisition, any shareholder who signed the requisition may call the meeting. The corporation is required to reimburse the shareholders for expenses they reasonably incurred in requisitioning, calling and holding the meeting unless shareholders resolve otherwise at the requisitioned meeting. However, what happens when the shareholder calls the meeting is not entirely clear: the statute provides little guidance, and there is scant precedent to look to because in virtually all cases the corporation calls the requisitioned meeting.

Although this statutory right is clearly enshrined, again, the *Bioniche* case casts some uncertainty over whether this right would be supported by the courts if challenged. Following their first failed attempt to requisition a meeting, the dissident Bioniche shareholders submitted a second, fully compliant requisition. Before the requisition was submitted, the board of Bioniche announced that it had set a date for the company's annual shareholders' meeting and established a record date for the meeting. The announcement was made six months prior to the meeting date, much earlier than the date the meeting would normally be announced. The board then relied on a provision in the corporate statute that relieves a board from having to call a shareholders' meeting in response to a requisition if a record date for a meeting has already been set. Although the Court concluded that the right of a shareholder to call a meeting applies when a board declines to do so, even if a board has already fixed a record date, the Court added that "a court would be unlikely to *uphold a*

5 2013 ONSC 4871.

6 2013 ONSC 727.

meeting called by a shareholder" in circumstances in which one of the statutory exceptions to the board's obligation to call a meeting applies. The *Bioniche* case is another example of the courts' propensity to limit shareholders' access to statutory rights.

Bioniche also illustrates how Canadian courts have allowed boards to use technicalities to defeat requisition rights. The Court agreed with the dissident Bioniche shareholders that the board's early announcement of the record date for the annual meeting was clearly calculated to allow the board to reject a valid requisition; however, the Court declined to find fault with the board's actions, applying the deferential business judgment rule standard of review to the board's actions and concluding that the effect of delaying the dissidents' ability to challenge management by six months was reasonable in order to allow the board to pursue the business plan that it believed was in the company's best interests.

The combined effect of these judicial developments presents a significant challenge for shareholders seeking to requisition a meeting to change a board. As a consequence of these limitations, the vast majority of proxy contests unfold at annual shareholder meetings. For example, of the 189 proxy contests in Canada in the six-year period from 2010 to 2015, only 34 were initiated by requisition.

2 Stake Building and Beneficial Ownership Reporting

Ordinarily, shareholders acquiring a significant position in a Canadian listed company are required to issue a public early warning report disclosing their ownership once they acquire beneficial ownership of 10% or more of any class of equity or voting securities of the company. Upon reaching 10%, the shareholder is required to promptly announce its acquisition by press release, file an early warning report within two trading days of the acquisition and stop acquiring any further securities of the relevant class for one full trading day after the filing of the early warning report.[7] Thereafter, the shareholder must report increases and decreases of 2% or more, as well as when shareholdings fall below the 10% ownership threshold.

As a result of amendments in May 2016 to the early warning reporting regime, more detailed disclosure is now required regarding the purpose of the acquisition and the shareholder's intentions with respect to the issuer. The scope of the disclosure in many ways resembles the requirements of Rule 13d under the U.S. *Securities Exchange Act of 1934*. In particular, early warning reports must state the purpose of the shareholder and its joint actors in acquiring or disposing of the issuer's securities and describe any plans or future intentions the shareholder and its joint actors may have that relate to or would result in, among other things, a corporate transaction, capitalization or dividend changes, board or management changes or proxy solicitations.[8]

Canadian early warning reporting requirements are regarded by some as being more lenient than those under Rule 13d because the Canadian requirement is triggered at 10%, whereas the U.S. requirement is triggered at 5%. However, the U.S. rules provide a considerably longer grace period for disclosing one's position – the initial report must be filed within 10 days in contrast to Canada's requirement for an immediate press release – and the U.S. rules do not impose a trading moratorium.

ALTERNATIVE MONTHLY REPORTING

Under the Canadian regime, there is an exception from the obligation to issue a press release and immediate early warning report as well as from the trading moratorium for shareholders eligible to use the Alternative Monthly Reporting System (AMRS).[9] Under the AMRS, rather than issue an immediate report, the shareholder

7 National Instrument 62-103, *Early Warning System and Related Take-Over Bid and Insider Reporting Issues* (NI 62-103), Part 3, and National Instrument 62-104, *Take-Over Bids and Issuer Bids* (NI 62-104), Part 5.

8 NI 62-103, Form 62-103F1, Item 5 and Form 62-103F2, Item 5.

9 NI 62-103, Part 4.

must file a report within 10 days of the end of the month in which the 10% threshold is crossed. To rely on the AMRS, the shareholder must be an "eligible institutional investor." This includes financial institutions, mutual funds and pension funds, and generally includes investment funds such as hedge funds that are managed by a registered investment adviser (including advisers registered by the U.S. Securities and Exchange Commission (SEC) under the U.S. *Investment Advisers Act of 1940*).

DISQUALIFICATIONS FROM AMRS

A shareholder will be disqualified from AMRS eligibility if the shareholder intends to make a formal takeover bid for the company or to propose a transaction that would give the shareholder effective control over the company. A shareholder is also disqualified if the shareholder solicits proxies (including via private solicitation under an exemption) in support of dissident board nominees or in support of a merger not supported by the issuer's management or in opposition to a merger proposed by the issuer's management.[10] Notably, merely having an intention to propose a dissident slate at a shareholders' meeting or holding securities for the purpose of influencing the control or management of the company do not disqualify the shareholder from relying on the AMRS. This is in contrast to Rule 13d, which requires a shareholder to switch from a Schedule 13G filing to a Schedule 13D filing if its intention changes from being a passive investor to being active (for example, as a result of deciding to propose a nominee for the board or merely having the purpose or effect of influencing the control of the company).

ALTERNATIVE INVESTMENT MANAGEMENT ASSOCIATION SUBMISSIONS

The amendments to the early warning reporting system and the AMRS that came into force in May 2016 were the result of an effort begun in March 2013 by the Canadian Securities Administrators (CSA), which is the association of Canadian provincial and territorial securities regulators, to revise Canada's beneficial ownership reporting regime. The CSA had initially proposed lowering the disclosure threshold under both the early warning regime and the AMRS from 10% beneficial ownership of equity or voting securities to 5%. Owing to numerous comment letters that the CSA received from various market participants, including a comprehensive submission made by the Alternative Investment Management Association (AIMA) and the Managed Funds Association (MFA) with the assistance of Davies Ward Phillips & Vineberg LLP, the CSA resolved to leave the early warning reporting and the AMRS disclosure thresholds at the current 10%. The AIMA and MFA submission made the case that engaged shareholders and activist investors serve as a check on management, contain agency costs, improve corporate governance and have been shown in a number of empirical studies to have a positive impact both on firm value and operating performance of target companies. The full text of the MFA and AIMA comment letter is available at http://www.osc.gov.on.ca/documents/en/Securities-Category6-Comments/com_20130712_62-104_kaswellsj.pdf.

TREATMENT OF DERIVATIVES

The MFA and AIMA comment letter was also successful in advocating that equity equivalent derivatives not be included in determining whether an early warning report obligation is triggered. Initially, the CSA had proposed that all derivatives giving the holder the economic equivalent of ownership should be included in determining the holder's beneficial ownership, regardless of whether the derivatives were cash-settled or gave the holder the right to require delivery of the underlying shares. In response to comments on the proposed rules, including from AIMA, the CSA determined not to require inclusion of equity equivalent derivatives in determining whether an early warning reporting obligation is triggered.

However, to address concerns of some commenters that derivatives are used to hide ownership of shares, the CSA has provided guidance regarding circumstances in which an investor will be deemed to beneficially own shares underlying an equity derivative. For example, an investor could be deemed to beneficially own shares

10 NI 62-103, s. 4.2.

underlying a derivative (whether or not cash-settled) when it has the ability formally or informally to obtain the securities or to direct the voting of securities held by a counterparty to the derivative.

3 Competition/Antitrust Legislation

Canada's antitrust regime does not impose notification or government-clearance obligations at the early stake-building stage by the activist and does not, unlike the *Hart-Scott-Rodino Antitrust Improvements Act of 1976* (HSR Act) in the United States, distinguish between shareholders with passive intent and those with an intention to effect change in the policies of the target company. In Canada, notification under the *Competition Act* is not required until the acquirer acquires more than 20% of the target's voting shares, and notification under Canada's *Investment Canada Act* is not required for an acquisition of less than a one-third voting interest in a Canadian business. In contrast, in the United States, the HSR Act can work, in effect, as an early warning system requiring notification of the target and government clearance at the early stake-building stage and a lengthy moratorium on purchases after the filing with the regulatory authority – even where the target is a Canadian company.

4 Group Formation: Insider Trading and Joint Actor Characterization

One of the challenges faced by activists in Canada is to gauge and organize support from major Canadian institutional investors. Canadian institutions are wary about aligning themselves publicly with a dissident shareholder, at least at the beginning of a long contest, primarily out of concern to preserve their freedom to trade in the securities of the target issuer. Their concern stems from two considerations: insider trading and joint actor characterization.

INSIDER TRADING

Under Canadian insider trading rules, a person in a special relationship with a public company[11] is prohibited from trading with knowledge of material information that has not been generally disclosed. This prohibition extends to anyone who learns of material information from a special relationship person. The Canadian rules are statutory and do not turn on notions of "duty" and "misappropriation." The category of "special relationship" persons is large and includes a person that beneficially owns more than 10% of the voting securities of the target company. Thus, an activist holding more than 10% of a company's shares is a person in a special relationship with the company. Non-public information that the activist may learn in its discussions with the target company about, for example, the target's business plans or the target's response to the activist's proposals may amount to material undisclosed information that, if communicated by the activist to the institutional shareholder, will restrict that shareholder's ability to trade. It is even possible in these circumstances that information about the activist's own plans vis-à-vis the target company could amount to material undisclosed information that, if disclosed to the institutional shareholder, would similarly restrict the shareholder's ability to trade.

JOINT ACTORS

The second concern relates to the issue of "joint actor" characterization, which under Canadian securities law is relevant both for purposes of the early warning disclosure requirements and for compliance with Canada's takeover bid regime.

11 The net cast by the insider trading rules was widened in 2016 by a statutory amendment to cover not only the securities of Canadian public companies but also the securities of any issuer, wherever situated, whose securities are publicly traded.

Under Canadian securities legislation, if the activist has an agreement, commitment or understanding with another shareholder that they intend to exercise voting rights in concert, they will be *presumed* to be joint actors. If the agreement, commitment or understanding is with respect to the acquisition of shares of the target company, they will be *deemed* to be joint actors. As a consequence, their holdings will be aggregated for purposes of determining whether the 10% early warning disclosure obligation has been triggered, and the joint actor will have to be named in the activist shareholder's early warning report. The mere formation of a group holding more than 10% will not trigger a filing obligation unless it is a change in a material fact stated in a previously filed report.

Perhaps more significantly, their holdings will also be aggregated for purposes of determining whether the mandatory takeover bid rules have been triggered. Canadian securities legislation requires that the acquisition of more than 20% of the outstanding voting or equity securities of an issuer be made through a formal takeover bid to all shareholders, subject to limited exceptions. The mere formation of a group holding more than 20% will not trigger the rule, but the first purchase of even a single share by a member of the group will require compliance with the bid regime unless the purchase can be made under one of the limited statutory exemptions. Accordingly, the activist and the institutional shareholder will need to ensure that their purchases and sales are coordinated in a manner to ensure compliance with the takeover bid rules and with Canada's early warning disclosure rules. As a result, the activist and the shareholder will be unable to trade without each other's knowledge and, presumably, agreement.

Relatively recent case law in Canada confirms that the issue is not merely a theoretical one. In the August 2013 Alberta Queen's Bench decision in *Genesis Land Development Corp. v Smoothwater Capital Corporation*,[12] the Court found that the activist shareholder Smoothwater Capital was acting jointly and in concert with other shareholders of the targeted company from the date on which the parties participated in a conference call together with a proxy solicitation firm (because it could be inferred from that conduct that the parties had reached an understanding that they would support the proposed new slate of directors by voting in favour of the slate).

5 Poison Pills

Many Canadian and U.S. public companies have adopted poison pills[13] that provide that if an "acquiring person" exceeds a specified level of ownership (typically 20%), all shareholders other than the acquiring person can purchase stock at a substantial discount to the market price of the shares, resulting in significant dilution to the acquiring person. Canadian poison pills, like U.S. pills, treat an acquiring person as the beneficial owner of shares owned by it and its joint actors. However, Canadian pills have evolved differently from U.S. pills because the Toronto Stock Exchange (TSX) requires that pills be approved by shareholder vote. This requirement has given shareholders and ultimately Institutional Shareholder Services Inc. (ISS) considerable influence over the terms of poison pills. One way in which Canadian pills differ from U.S. pills is that typically the definition of "joint actor" will *not* include persons with whom the acquiring person has an agreement to jointly vote shares, but rather only persons with whom the acquiring person has an agreement with respect to the acquisition of shares. Moreover, U.S.-style voting pills that expand definitions of "beneficial ownership" or "acting jointly or in concert" to capture agreements among investors to vote together or campaign to change or influence the control of an issuer have not gained ground here. Commentary by Canadian securities regulators that echoes the voting guidelines of proxy advisory firms in Canada has made clear that rights plans should be effective

12 2013 ABQB 3793.

13 Despite the May 2016 amendments to Canadian takeover bid rules that extend the minimum bid period to 105 days and largely obviate the utility of a Canadian-style poison pill as a defence tactic, poison pills remain common in Canada to guard against "creeping" bids – the acquisition of positions over time in excess of 20% of an issuer's shares through transactions exempt from the takeover bid rules, such as private agreement and normal course purchases.

only against takeover bids and should not apply to transactions or circumstances involving a shareholder vote such as contested director elections.

6 Selective Disclosure

In Canada, the extent to which an activist can communicate information to other shareholders is not entirely resolved. Disclosure of material non-public information by a special relationship person (for example, a 10%-plus shareholder) to another person constitutes "tipping" under Canadian securities law. Moreover, unlike in the U.S., tipping is prohibited regardless of how the recipient acquired the information and regardless of whether the recipient enters into a confidentiality agreement to maintain the confidentiality of the information.

There is a specific carve-out for a person considering, evaluating or proposing to make a takeover bid to become a party to a business combination or to acquire a substantial portion of a reporting issuer's property that allows the person to disclose material information in the necessary course of its business to effect such a transaction. However, no similar statutory exception exists for disclosures made by a person proposing a board change or proxy contest.

For the activist shareholder holding more than 10% of a company's shares, the question is whether the activist's disclosure to others of its intention to pursue a board change or proxy contest constitutes prohibited tipping. The activist's plans may not amount to a "material fact" – that is, a fact "that would reasonably be expected to have a significant effect on the market price or value of the securities"; but if the plans do amount to a material fact, the only basis upon which disclosure of those plans to another would not constitute tipping would be if the disclosure were made in the necessary course of business. "Necessary course of business" does not mean in the "ordinary course of business." What is unresolved is whether these words mean "in the necessary course of the *issuer's* business" – to allow communications between an issuer and its counsel or an issuer and its lender, for example – or whether they can be read to mean "in the necessary course of the *tipper's* business." The specific statutory carve-out for a person considering, evaluating or proposing to make a takeover bid or to become a party to a business combination that was noted above does not apply here. Given this uncertainty and given the activist's susceptibility to legal challenge, activists must exercise caution and may be practically constrained from communicating information to other shareholders whose support they are seeking. Caution is also dictated by the fact that Canadian securities regulators have demonstrated a willingness to use their "public interest" jurisdiction to sanction trading or tipping conduct that does not technically offend the statute but that results in some unfair advantage to the trader or the tippee.[14]

7 Voting Shares Acquired After the Record Date

The question of who is entitled to vote at a shareholders' meeting is determined by the particular corporate statute under which a company is incorporated. The CBCA stipulates that only a shareholder whose name appears on the shareholders list on the stated record date for the meeting is entitled to vote at the meeting. However, corporate legislation in several provinces and territories of Canada allows a purchaser of shares after the record date to vote at the meeting so long as the purchaser produces properly endorsed share certificates or otherwise establishes the purchaser's ownership of the shares and asks the corporation (typically not later than 10 days before the meeting) to have his or her name included in the list of shareholders entitled to vote.

14 *Re Suman* (2012), 38 OSCB 2809; *Re Donald* (2012), 35 OSCB 7383; and *Re Hariharan* (2015), 38 OSCB 3356, 3373.

8 Empty Voting

The issue of empty voting (exercising voting power without a corresponding equity interest) garnered significant attention as a result of Mason Capital Management LLC's (Mason's) opposition to a capital reorganization proposed by TELUS Corp. to collapse its dual-class share structure.

In February 2012, TELUS decided to collapse into a single class its non-voting and voting shares (which aside from voting rights were essentially identical) in order to align the distribution of voting rights with the capital investment made by investors and to enhance the liquidity and marketability of TELUS shares. As a result of the announcement, the historical 4%–5% spread between the trading prices of the two classes of shares narrowed because TELUS was proposing to convert non-voting shares into voting shares on a one-for-one basis. After the announcement, Mason acquired almost 19% of the voting shares, but hedged that position by selling short both voting and non-voting shares, so that Mason's economic exposure to TELUS was only 0.21% of TELUS's outstanding shares. The disconnect between Mason's right to vote almost 19% of the TELUS common shares and Mason's small economic interest in the company led to Mason being labelled an "empty voter." Mason's strategy was to defeat the share collapse proposal and profit when the spread between the trading prices of the voting and non-voting shares was restored. Ultimately TELUS was successful in accomplishing the share collapse.

During the contest between Mason and TELUS, the British Columbia courts had several occasions to comment on the concept of empty voting. The first occasion arose in the context of a TELUS application to the B.C. Supreme Court to invalidate on technical grounds a requisition for a shareholders' meeting made by Mason. Although the Court did not rule on the empty voting issue, it issued a strong statement against empty voting, stating in *obiter* that a court might use its power to deny an empty voter the right to requisition a meeting. On appeal, the B.C. Court of Appeal reinstated Mason's requisition and disagreed with the lower court's statement that the courts have the authority to intervene in cases of empty voting, even on broad equitable grounds. The appeal Court stated that any remedy must lie in legislative or regulatory change. The third occasion arose in the final court proceeding (to approve the plan of arrangement under which the collapse was effected). In that proceeding, the B.C. Supreme Court was again critical of Mason's tactics and considered Mason's lack of economic interest, despite its voting interest, to be relevant to the Court's consideration of Mason's objections to the fairness of the collapse. However, Mason's right to vote its shares, despite its lack of a commensurate economic interest, was never in doubt.

The contest between TELUS and Mason highlighted the complexity of the empty voting issue. Since then, Canadian corporate and securities regulators have continued to grapple with the question of what, if any, legal changes might be appropriate in light of commenters' expressed concerns over the empty voting issue. For example, the May 2016 changes to the beneficial ownership reporting regimes, discussed above, require enhanced disclosure aimed at identifying situations in which empty voting might exist. Amendments to the CBCA proposed in 2016 (but not yet implemented) do not contemplate any changes being made to the federal corporate statute to address concerns over empty voting.[15]

9 Classified Boards

Canadian corporate statutes generally provide that the shareholders may, by ordinary resolution at a special meeting, remove one or more directors from office and elect their replacements. This right, coupled with the right of shareholders to requisition meetings to remove directors, prevents Canadian corporations from implementing "classified" or "staggered" boards in which directors are elected for multiple-year terms with only a subset of the board subject to turnover at any given annual meeting. Moreover, the TSX rules prevent

15 Bill C-25, *An Act to amend the Canada Business Corporations Act, the Canada Cooperatives Act, the Canada Not-for-profit Corporations Act and the Competition Act* (CBCA Amendments).

classified boards for TSX-listed issuers by requiring that shareholders be permitted to vote on the election of all directors at each annual meeting of shareholders. As a result, at each annual meeting a dissident has the ability to take control of the board.

10 Majority Voting

Majority voting is firmly entrenched in Canada for Canadian corporations, with the result that shareholders have a meaningful opportunity to annually express their views on individual directors in director elections. Majority voting replaces the historical practice of electing directors as a slate on a plurality basis in uncontested elections. Under the TSX rules, all TSX-listed issuers other than majority-controlled corporations must have a majority voting policy and disclose the results of that vote. Each director is required to get more "for" than "withhold" votes, failing which the director is required to tender his or her resignation for acceptance by the board, and the board must accept the resignation absent "exceptional circumstances." To date, however, several issuers have relied on the exceptional circumstances carve-out to allow directors who fail to receive a majority of "for" votes to remain on the board, despite the will of shareholders to the contrary.

Proposed amendments to the CBCA as well as recent guidance issued by the TSX suggest that "true majority voting" is on the horizon in Canada. The TSX stated in its March 2017 staff notice that reliance on exceptional circumstances must meet a high threshold.[16] Examples of exceptional circumstances include the resignation of that director resulting in the issuer not being in compliance with corporate or securities laws or commercial agreements, the subject director being a member of a key active special committee, or majority voting being used for a purpose inconsistent with the policy objectives underlying majority voting. Factors that would not be relevant to determining whether exceptional circumstances exist include the director's qualifications, experience or contributions to the issuer.

Proposed amendments to the CBCA would make majority voting a legal requirement under corporate law.[17] Under those amendments, if adopted, a director who fails to receive 50% plus 1 "for" votes would not be elected as a matter of law; the board would be prohibited from relying on its corporate law right to fill vacancies on the board to appoint a director who did not receive majority shareholder approval unless that director is needed on the board to satisfy statutory director independence or Canadian residency requirements.

11 Limited Private Proxy Solicitation and Advance Notice Bylaws

Canadian securities laws and most corporate statutes provide an exception to the proxy solicitation rules, allowing shareholders (but not the company) to avoid having to send a dissident proxy circular to shareholders if the total number of shareholders whose proxies are solicited is not more than 15 (joint holders being counted as one shareholder).[18] This method of solicitation is inexpensive and may be effective when the ownership of voting shares is concentrated in the hands of a few shareholders.

Aside from the limit on the number of shareholders that a person may solicit, there are very few constraints on the manner in which a shareholder relying upon this exemption may solicit proxies. In some past instances, dissidents have quietly conducted limited solicitations of proxies from a small number of large shareholders and "ambushed" management at an annual meeting by nominating their own alternative slate of directors from the floor without any prior warning.

16 TSX Staff Notice 2017-0001 (March 9, 2017).

17 CBCA Amendments (see footnote 15) and proposed amendments to *Canada Business Corporations Regulation, 2001*. Proposed amendments to the OBCA (see footnote 3) would similarly mandate majority voting for corporations incorporated in Ontario.

18 CBCA, s. 150(1.1) and National Instrument 51-102, *Continuous Disclosure Obligations* (NI 51-102), s. 9.2(2).

An advance notice bylaw, requiring a shareholder to provide advance notice to an issuer if it wishes to propose nominees to the board, can of course eliminate the risk of an ambush. Advance notice bylaws have gained significant traction in Canada over the past several years. In 2012, Canadian courts condoned the use of these bylaws on the basis that they foster an orderly nomination process and informed decision-making by providing shareholders with reasonable notice of, and information concerning, a contested election of directors. As a result of support for these bylaws, many Canadian issuers have now adopted them. By the end of the 2016 proxy season, more than a majority of Canadian issuers listed on the S&P/TSX Composite and SmallCap indices had adopted such bylaws.

In late 2014/early 2015, ISS and Glass Lewis & Co. (Glass Lewis) issued more restrictive guidance for evaluating advance notice requirements in Canada, taking a negative view of onerous disclosure requirements and provisions that allow a board of directors to postpone a meeting without a corresponding extension to the nomination deadlines. The reformulated policies were largely in response to the Ontario Superior Court's 2014 decision in *Orange Capital, LLC v Partners REIT*,[19] in which the Court found that advance notice requirements are to be used only as a "shield" to protect shareholders and management, not as a "sword" to prevent nominations by shareholders or to buy time for management to defeat an activist.

ISS and Glass Lewis have also reformulated their policies to identify acceptable features of advance notice requirements versus those that may be offensive and may trigger negative recommendations by the proxy advisory firms. In 2017, the TSX also weighed in on advance notice bylaws and provided guidance on which features of advance notice bylaws will and will not be viewed as acceptable.[20] In the TSX's view, advance notice bylaws that frustrate or circumvent shareholders' rights under the TSX's prescribed director election requirements are not acceptable. For example, advance notice provisions that require nominating shareholders to be present at the meeting or to provide unduly burdensome or unnecessary disclosure or to complete questionnaires, make representations or submit agreements or give consents beyond those that would be required from management or board nominees are generally not acceptable to the TSX, ISS or Glass Lewis. In light of these policy reforms and the *Orange Capital* decision, issuers will need to adopt bylaws with reasonable terms and apply them in a manner that is commercially reasonable and not tactical or intended to thwart a shareholder seeking to exercise its fundamental shareholder franchise to elect nominees.

12 Public Proxy Solicitation and the Broadcast Exemption

Canadian rules provide a "public broadcast" exemption that can be used alone or in combination with the 15-shareholder exemption discussed above to enable a dissident (but not an issuer's management) to solicit proxies and support for its campaign without "sending" a proxy circular to shareholders.[21] To rely on the exemption, the solicitation must be made by public broadcast or publication (for example, by press release, statement on radio or television, publicly available website or public speech), and prescribed materials and disclosure must be filed on SEDAR, together with the communication intended to be published. For activists seeking to rely on this exemption in connection with the election of directors, a document containing prescribed information concerning the proposed nominees must also be filed on SEDAR.[22]

Pershing Square's successful campaign to elect its nominees to the board of Canadian Pacific Railway serves as a good example of the utility of the broadcast exemption to activists and the flexibility it affords to engage in a robust solicitation campaign, particularly in the early stages, without incurring the additional costs and

19 2014 ONSC 3793.

20 TSX Staff Notice 2017-0001 (March 9, 2017).

21 CBCA, s. 150(1.2) and NI 51-102, s. 9.2(4).

22 NI 51-102, s. 9.2(6). Compliance with the broadcast exemption entails other obligations, a discussion of which is beyond the scope of this article.

burdens of mailing a dissident information circular. In the case of Pershing Square, reliance on the exemption, combined with the filing of an initial "pre-emptive" proxy circular, enabled Pershing Square to mount a multi-faceted solicitation campaign involving public town hall meetings, press releases, speeches, media interviews, shareholder one-on-one meetings and a customized website, over the course of months and long before Canadian Pacific Railway's management had filed its proxy circular. Since then, other activists proposing governance and board changes have relied on the public broadcast exemption to build shareholder support for their proposals before filing, or in the absence of, a dissident proxy circular.

Although issuers are prohibited from soliciting proxies prior to filing their management proxy circulars, they are not completely handcuffed from responding to an activist in the lead-up to filing. Smoothwater Capital Partners LP's (Smoothwater's) proxy contest to replace the board of Equity Financial Holdings Inc. (Equity) in late 2013/early 2014 illustrates the latitude a court may grant to an issuer that responds to an activist prior to filing its proxy materials. Smoothwater commenced its proxy contest in reliance on the public broadcast exemption, issuing a press release and then subsequently requisitioning a meeting. In response to a Smoothwater press release criticizing the Equity board and Equity's decision to delay the requisitioned meeting, Equity issued a press release defending the actions of its directors and outlining its concerns with Smoothwater's nominees and confirming that a proxy circular was forthcoming. The press release was issued before Equity had sent out its management proxy circular but the release confirmed that it was forthcoming. Smoothwater challenged the Equity release as an improper solicitation of proxies under the CBCA, claiming that the release constituted a solicitation (that is, a "communication to a shareholder under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy"[23]) prior to the filing of the management proxy circular. The Ontario Superior Court of Justice held that whether a communication is a solicitation is a question of fact that depends on the nature of the communication and the circumstances of the transmission. Looking to the principal purpose of the document, the Court held that the press release was simply a defence of Equity's leadership and of the date that it chose to hold the meeting, and that the release did not encourage shareholders to provide proxies to Equity.[24] The Smoothwater contest illustrates that an activist relying on the broadcast exemption cannot in every instance expect to go unchallenged by the issuer in the lead-up to filing the management proxy circular.

13 Private Placements During Proxy Contests

The private placement of shares into the hands of a friendly shareholder as a defence to a proxy contest has never been a common tactic in Canada. Among other things, the issuance of shares as a means of defeating a dissident's bid to oust incumbent directors could give rise to claims of breach of fiduciary duty and oppression of minority shareholders. However, this tactic was employed in a recent Canadian proxy contest involving Eco Oro Minerals Corp. (Eco Oro), prompting the Ontario Securities Commission (OSC) to intervene and reverse a private placement before a contested shareholders' meeting that threatened to tip the scales in favour of management.

For companies listed on the TSX, any private placement of shares must first be reviewed and accepted by the TSX. The TSX's rules generally require that a private placement be submitted for shareholder approval if it will have a material impact on control, or if it will result in the issuance of more than 25% of the outstanding shares at a discount to the current market price. Shareholder approval is also required if the placement will result in an issuance of more than 10% to insiders of the company.[25] Failure to comply with these requirements can result in the company being delisted.

23 CBCA, s. 147. See the discussion of "solicitation" in section 15 below.

24 *Smoothwater Capital Partners LP I v Equity Financial Holdings Inc.*, 2014 ONSC 324.

25 *TSX Company Manual*, ss. 604 and 607.

In April 2017, the OSC ordered the unwinding of a private placement by Eco Oro (a TSX-listed company) that involved a conversion of notes into common shares eight days prior to the record date for a contested shareholders' meeting.[26] The notes that were converted were held by certain insiders of the company and shareholders who were friendly to management. The notes had only recently been issued in connection with a financing that shareholders had vigorously opposed. Although the issuance of the common shares on conversion of the notes had been reviewed and accepted by the TSX, the dissident shareholders appealed the decision of the TSX to the OSC.

On April 23, 2017, the OSC reversed the TSX decision and ordered the unwinding of the private placement of shares. Although reasons have not yet been provided for the OSC's decision, main issues in the hearing were whether the TSX was adequately informed about the pending proxy contest and what the impact of the placement of shares would be on the contest. In concurrent proceedings before the British Columbia Supreme Court, the Court found that the share issuance was not oppressive because its primary purpose was debt reduction.[27] We expect that the OSC decision will result in the TSX more closely scrutinizing whether private placements are being proposed during the pendency or in anticipation of a proxy contest and what impact proposed share issuances will have on battles for control. The decision may also drive shareholders to seek remedies before the securities commission rather than the courts.

14 Compensation Arrangements for Director Nominees

One of the principal challenges that an activist faces is recruiting credible and compelling board candidates for a dissident slate. The growing prevalence and success of shareholder activism has been fuelled in part by the greater independence and quality of dissident nominees, and this in turn has raised the bar for activists: the credibility of the activist will judged on its ability to attract good dissident candidates.

To attract the best candidates, some activists have provided incentive compensation arrangements to those willing to serve as director nominees. In two high-profile proxy contests in 2013, this practice came under attack: one in Canada in which U.S. hedge fund JANA Partners sought to compensate its nominees proposed for election to the board of Agrium Inc., and one in the United States, in which Elliott Management Corp. entered into compensation arrangements with its nominees in its proxy fight with Hess Corp. More recently, in 2015, former Obama administration Auto Industry Task Force member Harry Wilson had been proposed as a nominee for the board of General Motors by four GM shareholders, each of which had agreed to compensation arrangements with Mr. Wilson.

In each of these examples, the director nominees were provided with compensation that included an incentive component tied to the performance of the target companies' shares over a certain period of time. In addition, compensation agreements often include a more modest fixed stipend as well as indemnity arrangements; however, these components have not attracted notable criticism.

Activists have argued that incentive payments are consistent with good corporate governance because they help link director pay to performance, which can benefit all shareholders. They also argue that these arrangements are necessary to attract better candidates who would otherwise have no compensation for their significant efforts unless ultimately elected to a board. On the other side, critics have labelled director compensation arrangements as "golden leashes" leading to "poisonous conflicts" that create a subclass of directors, compromise the nominees' independence and create dysfunctional boardrooms. In particular, criticism has highlighted where time frames of the incentive arrangements are too short to align the dissident nominees with the long-term interests of shareholders. With respect to the GM situation, Warren Buffett

26 *Re Eco Oro Minerals Corp.* (2017), 40 OSCB 3890.

27 *Harrington Global Opportunities Fund Ltd. v Eco Oro Minerals Corp.*, 2017 BCSC 664 and BCSC 669.

remarked, "I totally disagree with the idea of putting somebody on the board who has an option on some other people's stock which is only good for two years."

The U.S. Council of Institutional Investors (CII) has criticized such third-party incentive arrangements on the basis that they "blatantly contradict" CII policies on director compensation. However, rather than promoting their outright prohibition, CII has encouraged the SEC to consider rule changes that would require dissident disclosure to investors about such arrangements because existing rules fall short of such requirements.

Despite criticism from the investor community, efforts to prohibit these incentive arrangements through bylaw amendments have foundered. Such bylaw limitations had been first proposed by law firm Wachtell, Lipton, Rosen & Katz LLP in 2013, and had been adopted by several U.S. companies. In response to these bylaws, ISS stated that the adoption of restrictive director qualification bylaws without shareholder approval "may be considered a material failure of governance because the ability to elect directors is a fundamental shareholder right." ISS has gone on to say that it may recommend votes against or withheld from director nominees consistent with ISS's "Governance Failures" policy whereby such bylaws are implemented by boards.

In light of the continued debate over the issues, activists seeking to implement compensation arrangements with their nominees will need to be careful about how they are crafted to allay concerns about nominee independence and alignment with the long-term interests of shareholders. Although compensation during the pendency of a proxy contest will likely continue to be acceptable, post-election compensation arrangements funded by the activist are more likely to be scrutinized by shareholders. Activists will therefore need to consider whether offering compensation, while helpful in attracting candidates, might alienate shareholders and jeopardize chances of success.

15 Proxy Access: Nominations for Directors Through Shareholder Proposals

SHAREHOLDER PROPOSALS

Shareholders of Canadian corporations have long had the ability to use the shareholder proposal regime to submit nominations for the election of directors. Any nominees submitted by a proposal must be included in the management proxy circular for the corporation's annual general meeting.

To be eligible to submit a shareholder proposal, a shareholder must hold voting shares equal to at least 1% of the outstanding voting shares or whose fair market value is at least $2,000. Such shares must have been held for at least six months prior to the shareholder submitting the proposal.[28] In addition to these requirements, a shareholder proposal to nominate a director must be signed by one or more holders of shares representing in the aggregate not less than 5% of the shares entitled to vote at the meeting.[29] There is no limit on the number of nominees that may be submitted by proposal.

The corporation can reject a proposal on a number of grounds, including that the proposal does not relate in a significant way to the business or affairs of the corporation. In addition, a corporation is not required to include a shareholder proposal in its management proxy circular if it is not submitted to the corporation at least 90 days before the anniversary date of the notice of meeting that was sent to shareholders in connection with the previous year's annual meeting.[30] Proposed amendments to the CBCA Regulations would change the prescribed period to at least 90 days (and not more than 150 days) before the anniversary of the prior year's

28 CBCA, s. 137(1.1) and CBCA Regulations, s. 46.

29 CBCA, s. 137(4).

30 CBCA, s. 137(5)(a) and CBCA Regulations, s. 49. Other corporate statutes (such as the OBCA) calculate the deadline differently.

meeting date. This proposed change would effectively allow for later submissions of shareholder proposals and may lead to greater use of the proposal mechanism for director nominations.

Although a dissident shareholder can save considerable expense by having the company include the shareholder's nominees in the management proxy circular, such inclusion does not relieve the dissident of an obligation to mail its own circular to shareholders if it wishes to engage in a general solicitation of proxies. Given the breadth of conduct that can fall within the definition of "solicitation"[31] under Canadian corporate and securities laws, for an activist seeking to communicate with and secure the support of other shareholders in advancing its campaign, the obligation to mail a dissident circular may therefore be triggered even if the activist has been successful in having its proposal included in the management proxy circular.

Interestingly, despite the great interest in proxy access among shareholders, including the continuing push by the shareholder community in the United States and Canada for improved proxy access over the past several years (discussed below), these long available Canadian shareholder proposal provisions have rarely been used for director nominations. This is likely due to four factors:

- The deadline for submitting a proposal typically occurs four to six months prior to a meeting date and has often passed before a dissident has firmed up its plans to take action. As discussed above, the proposed shortening of the period in proposed CBCA Regulations could increase the use of shareholder proposals for nominations.
- The statutory word limitation is not conducive to advocacy. The proposal and the statement to support it together cannot exceed 500 words.[32]
- As discussed above, shareholders with 5% of the shares already have the right to requisition a meeting. The deadline for requisitioning a meeting will typically occur much later than the deadline for submitting a proposal. Thus any shareholder considering submitting a nomination via a proposal could instead submit a requisition at a later date and then agree with management that the requisitioned business (e.g., to elect the dissident's nominees) could be dealt with at the annual meeting instead.
- Mere inclusion of a dissident's nominees in management's circular and on management's proxy card is generally not viewed as being sufficient to give a dissident any significant likelihood of success unless the initiative is accompanied by a robust solicitation effort by the dissident. Moreover, management has considerable control over how the dissident's nominees are presented in the circular and the management proxy card. Thus a dissident will typically prefer to mail its own circular to present its nominees and use its own proxy card.

Despite these drawbacks, the shareholder proposal mechanism is a potentially useful tool for a shareholder wishing to put its nominees up for election in the least expensive way possible. This could be particularly effective for a significant shareholder or group of shareholders who are not dependent on a broad public solicitation to win support for a dissident slate. Relying on management to include the dissident's nominees on the management proxy card and then privately soliciting up to 15 shareholders under a limited private solicitation could be sufficient in many cases to achieve a cheap and painless proxy contest victory.

PROXY ACCESS

In addition to the shareholder proposal right discussed above, other initiatives have been underway in Canada over the past two years to enhance proxy access for shareholders.

In May 2015, the Canadian Coalition for Good Governance (CCGG), the leading Canadian governance advisory group, released its policy statement on proxy access, bringing proxy access to the forefront of new governance

31 "Solicitation" includes a "communication to a shareholder under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy" (see CBCA, s. 147, "solicit" or "solicitation"). See also NI 51-102, s. 1.1, "solicit."

32 CBCA Regulations, s. 48.

initiatives in Canada. CCGG believes that shareholder participation in the nomination process should not be regarded as "simply a fall-back mechanism when other attempts to improve board performance have failed," but rather should be a matter of course as a principle of good corporate governance.[33] CCGG's policy statement encourages Canadian companies to voluntarily adopt proxy access policies as a means of enhancing direct shareholder engagement and improving the composition of Canadian boards. In many respects, CCGG's proxy access proposal is consistent with the standard that has evolved in the United States. However, there are some important differences, including the following:

- the ownership threshold for shareholder eligibility to nominate directors should be set at 5% for companies with market capitalization of less than $1 billion, and 3% for companies with market capitalization of $1 billion or more;
- for purposes of determining the 3% and 5% ownership thresholds, only voting interests that are tied to the economic interest should count; however, shareholders should be permitted to coordinate and aggregate their holdings to reach the required threshold without any proposed cap on the number of shareholders that can form a nominating group;
- the number of permitted shareholder nominees should be limited to three directors or 20% of the board, whichever is less;
- the right of the shareholder to nominate should not be conditioned on the shareholder holding shares for a prescribed period of time prior to the nomination; however, the shareholder should be required to hold the requisite number of shares until the time of the meeting; and
- the issuer should use a fair form (e.g., shareholder nominees are given the same prominence as management nominees and listed on the same page) of universal proxy (discussed in section 16 below).

Despite the flood of proxy access proposals that have emerged in the United States in the past few years, no Canadian issuer had faced a shareholder proposal for or adopted proxy access until this year, when two of Canada's largest banks – Royal Bank of Canada (RBC) and The Toronto-Dominion Bank (TD Bank) – received proposals to adopt a proxy access bylaw. The proposals were submitted to each bank by the same shareholder asking that their respective boards adopt a bylaw similar to the most typical U.S.-style proxy access bylaw, allowing shareholders beneficially owning 3% or more of the bank's outstanding common shares continuously for three years to nominate directors. The boards of both TD Bank and RBC recommended that shareholders vote against the proposals for a number of reasons. ISS and some major institutional investors supported the proposal, resulting in the proposal narrowly passing at TD Bank's annual shareholders' meeting on March 30, 2017, with 52.2% shareholder support. However, one week later, the same proposal was narrowly defeated at RBC's annual shareholders' meeting on April 6, 2017, with 53.2% shareholder votes against. Both banks have announced that they intend to defer their decision whether, and in what form, they will implement proxy access. Both banks also confirmed a commitment to continue the dialogue with stakeholders over the next year to consider a proxy access regime that may be appropriate for them and will revert to their shareholders in their 2018 proxy circulars.

In the meantime, amendments proposed to the OBCA in a private member's bill would make proxy access a statutorily entrenched right for shareholders of corporations incorporated in Ontario. If the proposed amendments are adopted,[34] the OBCA would allow registered or beneficial shareholders holding at least 3% of the shares or 3% of the class or series of shares entitled to vote at a meeting to nominate a single individual director nominee. If such a proposal is submitted, the corporation's proxy card must include the shareholder's nominee, and the shareholders are entitled to choose a person from their number to chair the meeting. The

33 CCGG Policy, "Shareholder Involvement in the Director Nomination Process: Enhanced Engagement and Proxy Access," May 2015, p. 2.

34 Bill 101, *Enhancing Shareholder Rights Act*, 2017.

2016 amendments proposed to the CBCA (discussed elsewhere) do not contemplate changing the existing shareholder proposal or proxy access rights for shareholders of federally incorporated companies.[35]

16 Universal Proxy

Canadian proxy solicitation rules are more flexible than their U.S. counterparts in that a dissident may use a "universal ballot" or "universal proxy" type of proxy card that includes management nominees on the dissident proxy card as well as the dissident nominees. This is distinct from the U.S. proxy rules, which currently[36] require the dissident to obtain the consent of each individual named on the dissident card.

A universal proxy in Canada enables the dissident to offer shareholders the option of picking and choosing among all candidates for election. For many shareholders, this makes the dissident card a more attractive option because they can tailor their votes by voting for their preferred mix of management and dissident nominees. For example, if a shareholder supports a dissident, but believes that the dissident slate put forward is too large, a universal ballot would allow the shareholder to vote for a subset of the dissident nominees and also vote for one or more management nominees. In September 2015, CCGG issued a policy statement encouraging the adoption of legislative amendments to mandate the use of a single form of proxy in contested director elections. Regardless of any legislative response, and until such time, CCGG is advocating that Canadian issuers voluntarily adopt the practice of universal proxies.[37]

A universal proxy was first used successfully in Pershing Square's proxy contest for Canadian Pacific Railway.[38] In that contest, both sides ended up using universal proxy cards – management doing so pre-emptively, presumably so that its card would not be viewed as less flexible than Pershing Square's. Similarly, in JANA Partners' battle with Agrium in 2013, JANA used a quasi-universal proxy, in which it offered shareholders the choice of voting among seven incumbents that JANA would accept, plus five of JANA's nominees on its proxy card, in contrast to Agrium, which listed only the 12 management incumbents on its card. The use of universal proxies required customization to Broadridge's online voting system, which resulted in considerable additional expense to the early adopters. However, those system enhancements have been available to accommodate universal proxies in subsequent contests. In addition, the use of a universal proxy can provide an important informational advantage since, in the absence of some form of agreement between a dissident and the issuer, typically neither side will have advance access to proxies submitted on the other side's card. By using a universal proxy and persuading shareholders to use that proxy to cast their votes, activists may be able to secure a clearer picture of their prospects for success in advance of the meeting.

35 Additional information is available in our article titled "Are the Floodgates Open in Canada? First Proxy Access Bylaw Proposal Receives Narrow Majority Shareholder Approval" (March 31, 2017) (available at https://www.dwpv.com/Are-the-Floodgates-Open-in-Canada). You can also read more about proxy access, shareholder proposals and other top trends and issues in corporate governance in Canada in *Davies Governance Insights 2016* (available at https://www.dwpv.com/Davies-Governance-Insights-2016).

36 In October 2016, the SEC proposed new rules that would require parties soliciting proxies in contested director elections to use universal proxies. The proposal is still in the comment phase. Additional information is available in our article titled "Proposed SEC Rules Requiring the Use of Universal Proxies" (February 16, 2017) (available at https://www.dwpv.com/SEC-Rules-on-Universal Proxies).

37 The proposed amendments to the OBCA discussed in section 15 above would, if adopted, require management to include on its proxy card the names of all director nominees contained in a shareholder proposal.

38 The dissidents in Biovail Corporation's 2008 proxy contest also used a form of universal proxy, but were unsuccessful in that campaign. The dissidents also encountered technical difficulties with Broadridge Investor Communications Solutions (Broadridge) accepting online voting instructions on the dissident card.

17 Vote Buying: Soliciting Dealer Fees in Proxy Contests

The high-profile proxy contest in which JANA Partners sought to have five nominees elected to the board of Agrium Inc. brought under scrutiny the practice of companies compensating brokers through the payment of so-called soliciting dealer fees for soliciting shareholders' votes in favour of management.

The use of soliciting dealer fees was originally seen only in connection with takeover bids. In these transactions, bidders seeking to achieve success in their bids by meeting their minimum tender conditions would retain a dealer to form a soliciting dealers' group that would compensate brokers (at the bidders' cost) for getting their retail clients to tender to the bid. The fees served as a form of commission to brokers for shares tendered by their clients. Although the practice has raised some objection from shareholder advocates who maintained that the fees compromised the ability of brokers to provide unbiased advice to shareholders on whether to tender to a bid, the practice became fairly common.

Over the past decade, the use of soliciting dealer fees has migrated to Canadian M&A transactions conducted by way of a shareholder vote. In these situations, brokers are compensated for soliciting their clients' votes in favour of the transaction. In some cases, fees have been offered by rival bidders to encourage brokers to get their clients to vote against a competing transaction. Despite the variety of situations in which soliciting dealer fees have been seen, until 2012, the use of these fees had been limited to corporate transactions and had never been used in proxy fights relating to the election of a board of directors.

In 2012 and 2013, Canada witnessed the introduction of soliciting dealer fee arrangements by the incumbent board in various proxy contest contexts, including the 2012 proxy contest involving EnerCare Inc.; the 2012 battle between TELUS and Mason; and the 2013 proxy contest between JANA Partners and Agrium.

In the JANA/Agrium proxy contest in which JANA Partners sought to replace members of the board of Agrium, Agrium offered to pay soliciting dealer fees of $0.25 per share for each share voted in favour of the election of all of Agrium's incumbent directors. Unlike the earlier EnerCare contest, Agrium did not make any public disclosure of the payment of soliciting dealer fees, offering the fees in a confidential communication to broker-dealers. Agrium's use of soliciting dealer fees generated intense media coverage and negative reaction from shareholders, academics, the marketplace and international press, and focused attention on the propriety of the practice, not only in proxy contests for board elections but also in the context of M&A.

Numerous shareholder organizations and commenters condemned the practice, particularly in the context of a board election. Notably, the CCGG published an op-ed piece in Canada's *Globe and Mail* newspaper asserting that Agrium's "vote buying" was inconsistent with the basic tenets of shareholder democracy and the fiduciary duties of directors. *The Globe and Mail* also published an editorial criticizing the Agrium board for the practice.

The controversy arising from Agrium's use of the soliciting dealer fees has also raised questions about the legality of the brokers' participation in the practice under Canadian law. It has been noted that dealers in the United States will not engage in the practice on the grounds that by taking compensation for soliciting votes, they would run afoul of proxy solicitation rules in Rule 14a-2 under the *Securities Exchange Act of 1934*.

Despite the negative reaction and attention brought to soliciting dealer fees in these earlier proxy contests, currently, nothing expressly prohibits a board of directors from paying soliciting dealer feels in future contests, and no regulator, court or legislature in Canada has yet outlawed the practice. However, interestingly, Canadian proxy solicitation rules are substantially similar to the rules in the United States that are cited as prohibiting the practice.

Nevertheless, it seems certain that any board using the tactic would be subject to intense criticism and would risk alienating the very shareholders whose support it was hoping to secure.

18 Proxy Voting Infrastructure Reform

Concerns among market participants about the functioning of the proxy voting system in both Canada and the United States have attracted a great deal of attention over the past several years. In 2010, our firm published a white paper on the Canadian proxy voting system, titled The Quality of the Shareholder Vote in Canada (available at https://www.dwpv.com/Shareholder-Vote-in-Canada). The paper details the complexity of the proxy voting system and notes several areas of deficiency. Since the release of the paper in 2010, continuing discussions have taken place in the shareholder voting industry about the need for reform.

In response to identified deficiencies, over the past few years the CSA has focused on developing solutions to provide greater accuracy, reliability and transparency in the proxy voting infrastructure. In particular, the CSA has been working in consultation with industry experts to address perceived issues in the proxy voting infrastructure, including concerns with over-voting, missing votes, pro-rated votes and the lack of communication, transparency and end-to-end vote reconciliation and confirmation in proxy voting. The CSA's work in this area culminated in its publishing in January 2017 four non-binding protocols that delineate the roles and responsibilities of the key entities involved in the meeting vote reconciliation process and provide guidance on the operational processes that those entities should implement to make the proxy voting system more accurate, reliable and accountable.[39]

The protocols contain guidance designed to improve the accuracy of vote entitlement information provided to tabulators by intermediaries seeking voting instructions from beneficial owners, improve consistency in how voting entitlements are recorded, create consistency in tabulating and recording proxy votes and, notably, provide feedback from meeting tabulators to intermediaries and beneficial owners whose voting entitlements have been rejected or pro-rated (including the reasons why). The CSA intends to monitor key players' implementation of the protocols (which is entirely voluntary) over the 2017 and 2018 proxy seasons and will assess whether additional regulatory measures are warranted.

19 Regulation of Proxy Advisory Firms

In order to address some concerns related to the role and influence of proxy advisory firms such as ISS and Glass Lewis, the CSA adopted a national policy relating to the practices of proxy advisory firms in April 2015.[40] The policy applies to firms whose services to shareholders include analyzing matters put forward for consideration at shareholders' meetings, making voting recommendations and establishing voting guidelines for issuers. Rather than setting out strict rules of adherence, the policy lists best practices that the CSA encourages proxy advisory firms to follow. The best practices relate to four broad areas of concern:

- **Potential conflicts of interest arising from advisory firms' consulting activities.** The policy encourages proxy advisory firms to create written policies, internal safeguards and codes of conduct to identify, manage and mitigate both actual and potential conflicts of interest, and recommends that issuers regularly evaluate the effectiveness of such measures.
- **Voting recommendations.** The policy encourages proxy advisory firms to consider publishing the methods and procedures used in formulating voting recommendations to the extent that such disclosure would not compromise the proprietary or commercially sensitive nature of the information.
- **Proxy voting guidelines.** The policy encourages proxy advisory firms to establish written policies and procedures regarding their process for developing voting guidelines.
- **External communications.** The policy outlines the information that the CSA believes proxy advisory firms should share with their clients, including proxy advisory reports, information used from analytical models and assumptions used in performing an analysis.

39 CSA Staff Notice 54-305, *Meeting Vote Reconciliation Protocols*.

40 National Policy 25-201, *Guidance for Proxy Advisory Firms*.

Davies is a law firm focused on high-stakes matters. Committed to achieving superior outcomes for our clients, we are consistently at the heart of their largest and most complex deals and cases. With offices in Toronto, Montréal and New York, our capabilities extend seamlessly to every continent. Contact any of our lawyers to talk with us about your situation. Visit us at www.dwpv.com.

The information in this guide should not be relied upon as legal advice. We encourage you to contact us directly with any specific questions.

Patricia L. Olasker
polasker@dwpv.com
416.863.5551

Toronto
155 Wellington Street West
Toronto, ON M5V 3J7
TEL 416.863.0900

Montréal
1501 McGill College Avenue
26th Floor
Montréal QC H3A 3N9
TEL 514.841.6400

New York
900 Third Avenue
24th Floor
New York, NY USA 10022
TEL 212.588.5500

dwpv.com

DAVIES